Nos. 226, 227, 243, 266

IN THE

Supreme Court of the United States

OCTOBER TERM, 1948

Nos. 226, 227, 243

SECURITIES AND EXCHANGE COMMISSION, THOMAS W. STREETER, et al., THE HOME INSURANCE COMPANY, et al.,
Petitioners.

v.

CENTRAL-ILLINOIS SECURITIES CORPORATION, et al.

No. 266

CENTRAL-ILLINOIS SECURITIES CORPORATION and CHRISTIAN A. JOHNSON,
Petitioners.

v.

SECURITIES AND EXCHANGE COMMISSION, THOMAS W. STREETER, et al., THE HOME INSURANCE CO., et al.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

ANSWERING BRIEF OF CENTRAL-ILLINOIS SECURITIES CORPORATION AND CHRISTIAN A. JOHNSON, RESPONDENTS-PETITIONERS

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ANSWERING BRIEF OF CENTRAL-ILLINOIS SECURITIES CORPORATION AND CHRISTIAN A. JOHNSON, RESPONDENTS-PETITIONERS

I. PETITIONERS' EFFORTS TO CONVEY THE INFERENCE THAT THE INSTANT LIQUIDATION OF ENGINEERS (A) WAS THE VOLUNTARY ACT OF A "COMMON STOCKHOLDER CONTROLLED MANAGEMENT", AND (B) WAS PROPOSED IN ORDER TO FAVOR THE COMMON STOCKHOLDERS OVER THE PREFERRED, FIND NO SUPPORT IN THE RECORD, BUT ARE IN FACT REFUTED BY THE RECORD AND THE FINDINGS OF THE COURTS AND THE COMMISSION.

In their main briefs, petitioners have, in plain defiance of the record and the findings of the Commission and both Courts below, presented an inaccurate statement of the facts from which the legal issues in this controversy have arisen.

Petitioners have sought by inference and innuendo, not always subtle, to convey the impression that Engineers' plan of liquidation was voluntarily instigated by a management dominated by common stockholder interests, and was contrived primarily for the purpose of removing the preferred stockholders from "the enterprise" in a manner advantageous to the common stockholders.[1] These contentions, and many others of similar import, rest on nothing more substantial than petitioners'

[1] See, for example, statement in Brief for Thomas W. Streeter, p. 122:

> "The preferreds were unable to secure this participation due to the fixed attitude of the common which sought at the same time to eliminate the preferreds at a bargain price and keep for the common stockholders all the benefits of the flourishing underlying companies, using the Act as a cloak to accomplish their true objective."

Although the Brief for the Securities and Exchange Commission is somewhat more guarded, it contains a number of statements designed to convey a similar inference. Some of these are discussed *infra*.

imaginations, stimulated by advocates' zeal and motivation. They are devoid of all support in the findings of both Courts, as well as in those of the Commission; and, in fact, are affirmatively refuted by all three.

Indeed, the principal significance of these contentions is the plain demonstration they afford that petitioners deem it inadvisable to rest on the findings and opinion of the Commission in arguing their case here; and that they find it necessary, at this late date to supplement and revise the Commission's findings in an effort to counteract the decisions of the Courts below.

A. Engineers was compelled by the Act and the Commission's orders to retire the preferred stocks and to liquidate.

As we have shown in our main brief (pp. 38-44), the Commission and both Courts below found that, notwithstanding the fact that Engineers' plan was filed under Section 11(e) as a so-called plan of "voluntary" compliance, the dissolution therein proposed resulted solely from the impact of Section 11 of the Act and the Commission's orders thereunder, and was therefore truly involuntary. This accords with a long line of Commission and Court decisions.[1] However, petitioner Streeter argues that the "management and its counsel have consistently urged that the Act did not require the termination of the company's existence", and that "there is no order under 11(b)(2) requiring the liquidation of Engineers."[2] But what Streeter neglects to state is that

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[1] See cases cited at note 4, p. 55 and note 2, p. 38 of our Main Brief.

[2] Streeter Brief, pp. 101-2.

the company's contention that complete liquidation of Engineers was not a certainty was advanced in 1943 when Engineers was contesting in the Courts the constitutionality of Section 11 and the validity of the Commission's divestment orders thereunder. When those issues were decided adversely to Engineers' contentions, the management perforce recognized that there was no escape from the fact that Engineers and its entire system must be dissolved wholly and definitively.[1] The Commission had repeatedly held that a holding company devoid of economic justification is offensive to the standards of Section 11(b)(2) and must be dissolved,[2] and the Commission explictly concluded in this case that after Engineers disposed of El Paso and Gulf States as required by the Commission's orders under Section 11(b)(1), the company's continued existence would come within the prohibition of Section 11(b)(2): "Accordingly we find that

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[1] While Engineers' appeal was pending undecided before this Court (see our Main Brief, p. 6, note 1) the Court upheld the constitutionality of Section 11(b)(1) of the Act in *North American Co.* v. *S. E. C.*, 327 U. S. 686, and of Section 11(b)(2) in *American Power & Light Co.* v. *S. E. C.*, 329 U. S. 90.

Engineers' inability to obtain a reversal of the decision of the Court of Appeals for the District of Columbia, made necessary disposition of all its subsidiaries other than Virginia. Even to a late date in the proceedings respecting the plan, the management continued to hope for a decision which would permit Engineers to remain in existence (R. 808a). But when it became certain that only Virginia could be retained, it was clear that in such circumstances the Act commanded Engineers' dissolution (R. 675a-676a).

[2] See cases cited in our Main Brief, p. 7, note 1.

the proposal to dissolve Engineers is 'necessary' to effectuate the provisions of Section 11(b) of the Act" (R. 48a).[1]

However, even apart from the necessity of complete dissolution, it is indisputable that the divestments which Engineers had already made by 1943 in compliance with the Commission's orders necessitated the retirement of the preferred stocks in order to comply with the provisions of Section 11(b)(2) of the Act. In its opinion in *The Western Public Service Company*, 12 S. E. C. 804, 808 (1943) the Commission admonished Engineers to file "a comprehensive plan", including provision for "the readjustment of the capital structure of Engineers to conform to the revised scope of its operations". In similar situations the Commission has repeatedly held that such "readjustment" requires the complete elimination of all senior securities from the capital structure of the holding company,[2] and that holders of senior securities thus retired under the impact of the Act may not, in consonance with the "fair and equitable standard", receive cash payment of more

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[1] See also further finding quoted at p. 10, note 1, of our Main Brief.

Cf. concurring opinion of Commissioner Caffrey (R. 139a-140a):

> "I think that Engineers would have been subject to such a proceeding [mandatory dissolution] had it not come forth with a voluntary plan. Engineers' 'voluntary' proposal did no more than forestall the necessity for action by the Commission. * * *".

Cf. also discussion in *American Power & Light Co.* v. *S. E. C.*, 329 U. S. 90, 119-120, as to the propriety of the Commission's deferring entry of a mandatory order if the company tenders compliance with the statutory requirements by filing a bona fide plan under Section 11(e); and see special opinion of Mr. Justice Rutledge at pp. 123-124 concerning the Congressional intent with respect to encouraging the filing of Section 11(e) plans in preference to issuance of mandatory dissolution orders.

[2] See cases cited in our Main Brief, p. 43, note 2.

than the face amount of their securities.[1] In the light of these facts, it is evident that Streeter's contentions are wholly devoid of merit, and, as the Commission's opinion

[1] Thus, in its decision in *Cities Service Power & Light Corporation* (Holding Company Act Release No. 4944), the Commission held the "fair and equitable" standard interdicted payment of premiums upon retirement of debentures bearing an interest rate of 5½%, and three issues of preferred stock carrying dividend rates of $5, $6 and $7 respectively, even though the holding company was permitted to continue in curtailed form. The Commission stated (pp. 15 et seq.):

"In *The United Light and Power Company, supra,* and in *North American Light and Power Company,* we concluded that similar provisions for payment of redemption premiums were inapplicable when retirement of the securities involved was made necessary by the requirements of Section 11(b). We held that satisfaction of the securities there involved, without payment of redemption premium, was fair and equitable, and in both cases our decision was affirmed on appeal. See also *The United Light and Power Company,* — S. E. C. — (1943), Holding Company Act Release No. 4215, enforced *In re The United Light and Power Co.,* 51 F. Supp. 217 (D. C. Del., 1943); Court order appealed by Otis & Co., Intervenor, to the U. S. Circuit Court of Appeals for the Third Circuit; *North Continent Utilities Corporation,* — S. E. C. — (1943), Holding Company Act Release No. 4686, enforced *In re North Continent Utilities Corp.,* — F. Supp. — (D. C. Del., 1944).

"In each of the cases cited above we had entered an order that the issuer of the securities involved must be liquidated and dissolved by reason of the requirements of Section 11(b). No such order, however, had been entered in *Consolidated Electric and Gas Company,* — S. E. C. — (1944), Holding Company Act Release No. 4900. In prior findings in that proceeding we had found that disposition by Consolidated of its interest in a major subsidiary thereof was necessary to effectuate the provisions of Section 11; that compliance with Section 11(b) would involve substantially complete liquidation of that portion of the enterprise on which the Federated bonds (theretofore assumed and presently proposed to be paid by Consolidated) had a lien; that application of the proceeds of such sale to the retirement of bonds was a necessary consequence of the sale; and that simplification of the security structure of Consolidated by elimination of the Federated bonds was necessary to effectuate the provisions of Section 11(b)(2). In these circumstances,

and brief state, the "liquidation was caused by the Act and is in that sense 'involuntary' ".[1]

B. The record conclusively refutes petitioners' suggestions that the plan was formulated in order to favor the common stockholders over the preferred.

Commission Counsel, although conceding that Engineers' liquidation was compelled by the statute and there-

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we concluded that payment of the Federated bonds at their principal amount and accrued interest, as provided in the plan of Consolidated, was fair and equitable to the investors affected thereby.

"In the instant case, we have heretofore found, pursuant to Section 11(b)(1), that Power & Light must dispose of its interest in subsidiaries which then constituted over 55% of the consolidated assets of the Power & Light system. Originally controlling a widely scattered empire, Power & Light will be limited by the compulsory provisions of Section 11 to its Ohio properties. As stated above, elimination of all senior securities from the corporate structure of Power & Light is a necessary consequence of such partial liquidation, and is compelled by the provisions of Section 11(b)(2). Over $22,000,000 of the cash that Power & Light proposes to use in paying off its debentures and preferred stock consists of proceeds from the sale of its interests in three subsidiaries, disposed of as part of its program of compliance with Section 11 and our orders thereunder. . .

"This proceeding differs from those cited above in that a part of the money required to retire the publicly held senior securities is being raised by issuing and selling Notes to banks. We have considered the possibility that payment of premiums should be required on that portion of the publicly held debentures and preferred stock that is being so refunded. We have decided, however, that the distinction is not one of substance. Section 11 compels and the Plan proposes complete elimination of Power & Light's senior securities. Within the limits of this overall compulsion, Power & Light has some freedom of choice as to procedure and timing. We find below that the proposed Notes, which are expected to be of short duration, are an appropriate device for facilitating the required elimination of Power & Light's senior securities, and we do not believe the use of that method rather than some other makes the proposed retirement of any of its senior securities optional or voluntary." (Footnote references omitted.)

[1] S. E. C. Brief, p. 11.

fore was not voluntary, suggest in their brief that the particular form which that liquidation took—i.e., payment of cash to the preferred stockholders rather than an allocation of underlying securities—was chosen by a management "controlled by common stockholders" (p. 5) because it was regarded as "advantageous from the point of view of the common stockholders" (p. 23). Indeed, state Commission's Counsel, so "advantageous" did the management feel this form of plan to be that it was determined "to go forward with the plan irrespective of how that issue [the premiums] might be ultimately determined" (p. 7).[1] Both statements convey unwarranted and misleading implications, and are wholly inaccurate.

(1) To begin with, it must be pointed out that the record references set forth in support of the statement at page 7 and the related footnote at page 11 of the Commission's brief (R. 719a, 723a, 807a), do not in any way support the quoted statement. Examination of the cited pages discloses that in each instance a witness for the management testified that Engineers' board of directors considered it proper and appropriate to provide for the retirement of the preferred stocks by cash payment in the amount of the liquidating preference, and distribution of the residual assets to the common stockholders in dissolution. It was repeatedly testified by the company's officers that such a program was the one which the board of directors, with the exception of Streeter, felt was dictated

[1] This suggestion is reiterated in even stronger language at page 11, note 8, where it is stated: "The management has made it clear that they regarded the plan as desirable from the point of view of the common stockholders whether or not it should be held necessary to pay the preferred amounts equal to their voluntary liquidation preferences and redemption prices.

by the requirement of according the *preferred* holders fair and equitable treatment, without becoming involved in the uncertainties incident to a "one stock" plan.[1] Moreover, the company's president, who is shown by the record to have been a straightforward and candid witness, squarely testified that the common stockholder interests had expressed no desire to receive the stocks of the three underlying companies. He stated (R. 644a):

"Q. (By Commission Counsel): But in any of your discussions with the large stockholders did they show any preference to retaining their interests in these three operating companies I have just mentioned?

A. No, they did not. That question has never been suggested to me, and until you indicated by your line of questioning of Mr. Benjamin that you thought our policy in this matter may have been

[1] Thus, Barnes, president of Engineers, testified (R. 631a):

"On September 5, 1945, a meeting of the Board was held to authorize the filing of the present plan [providing for payment to the preferred of $100 plus accrued dividends]. At that meeting I called on each director individually to express his opinion, which they did. I do not recall now the particular points made by each director, but I do recall the statements made by Judge Wilson in substantially these words: 'The purpose for which the company was organized has been frustrated by the Holding Company Act and hence the fair thing to do is to return to the preferred stockholders the money which they put into the enterprise.'

The other statements were all favorable to the approval of the plan, with the single exception of Mr. Streeter."

See, also, testimony of Benjamin (R. 724a) that the Board felt that the preferred stockholders were entitled to receive cash payment of their charter liquidating preference, "and that the common stockholders should forego any dividends until the obligation to the preferred stockholders had been satisfied"; and see his further testimony that the Board felt that paying the preferred stockholders in cash was "the clearest way" of meeting the obligation to them, without involving them in "a determination of factors now which may vary considerably in the future" (R. 714a).

> influenced by what you described as the Stone & Webster interests, it was the first time that that thought had ever been put into my mind and I can assure you that I don't think there is any substance in it in fact."

And after Commission Counsel disavowed any intention of making such an intimation (R. 644a-645-a), Barnes stated:

> "I want to make it perfectly clear, definite and emphatic that there isn't anything to the implication that might be carried by that line of questioning" (R. 645a).

As support for the proposition that "the management regarded this type of plan rather than an allocation plan as advantageous from the point of view of the common stockholders",[1] we are referred to the same record citations discussed above (*supra*) in connection with the statement appearing at page 7 and note 8, page 11 of the same brief.

These record references no more support this statement than they did the earlier one. In each of the statements referred to, Benjamin (Secretary of Engineers) stated that the board of directors recognized that the retirement of the preferred stocks might have been accomplished by allocating to the preferred stockholders stock in some of the subsidiary companies; but far from stating that this was not done because it would have been disadvantageous to the common stockholders, Benjamin affirmed that the Board felt such an allocation plan would be complicated and uncertain, and "would require a determination of factors now which may vary considerably in the future. * * * The Board wanted to give the pre-

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[1] S. E. C. Brief, p. 23.

ferred stockholders the amount to which they were entitled, and they thought the clearest way of doing it was the plans that they had favored".[1]

(2) The suggestion that the Board might have felt that an allocation plan was apt to prove disadvantageous to the common stockholders is ironical in the light of the fact that, as we have plainly shown,[2] in the various allocation plans which have been consummated under Section 11(e) on a "going-concern basis" the senior security holders have received, in terms of current cash values, amounts far below their charter liquidation preferences. It is universally recognized that such allocation plans tend to favor the interests of the common stockholders, not of the preferred. Cf. *Otis & Co.* v. *S. E. C.*, 323 U. S. 624. However, such allocation plans generally involve very protracted proceedings, and on a number of occasions such plans have had to be brought back from the Courts for revision before the Commission because changed earnings figures and other material changes rendered them unfair or unworkable.[3] At a later point in their brief, Commission Counsel themselves assert the "unavoidable drawback" involved in the valuation

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[1] Benjamin further testified (R. 714a):

"It was not my understanding that they were seeking to avoid the responsibility or the work involved or the expense of making such calculations. My understanding of their feeling is that they felt that such calculations were necessarily uncertain because of the unknown factors which exist in any situation."

[2] See our Main Brief, pp. 89-90, 100-102.

[3] See *Northern States Power Company*, Holding Company Act Release No. 7950 at p. 6; *Standard Gas and Electric Company*, 63 F. Supp. 876; *Commonwealth & Southern Corp.*, Holding Company Act Release No. 8633, at p. 5; American & Foreign Power Company, New York Times, January 2, 1949, p. f-1, col. 6.

technique employed in one-stock plans which follow the principles of the *Otis* case.[1] Yet they do not hesitate to asperse Engineers' avowed desire to avoid that "unavoidable drawback", or to imply, improperly and incorrectly, that the management in fact avowed a completely different purpose. We have previously demonstrated (Main Brief, pp. 98 et seq.) how much less favorably the preferred would have fared under an allocation plan under the *Otis* formula.

In similar manner, counsel for the Commission suggest that Engineers' management at one time contemplated "a merger or consolidation", and point out that Engineers' charter provided that a merger or consolidation "should not be regarded as a liquidation, dissolution or winding up for the purposes of the paragraphs defining liquidation preferences".[2] Again the implication is that the management believed the preferred stockholders might receive more than the proposed payment of $100 per share plus dividends if the merger procedure were followed. Streeter's Counsel make explicit the suggestion which is implicit in the statement of Commission Counsel.[3] The implication is false, as the record plainly establishes. It was testified that Engineers' management had merely given consideration to the possibility that, *after* disposing of El Paso and Gulf States, Engineers might be merged with Virginia, its one remaining subsidiary, if tax ad-

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[1] S. E. C. Brief, p. 45, note 30.

[2] S. E. C. Brief, p. 78, note 46.

[3] See Streeter Brief, p. 102: "There are many ways Engineers could have chosen to comply with the Commission's divestment orders. The merger method which was an alternative originally under the plan was scrapped because of the appraisal requirements of state law."

vantages might thereby result. This possibility was abandoned because it was ascertained that no substantial tax advantages would be realized, and because the staff of the Commission urged that dissolution of Engineers itself should be effected.[1]

It scarcely needs to be pointed out that if in fact a management wished to find a way of "short-changing" the preferred stockholders,[2] the merger technique is the classic device for accomplishing that objective.[3] The cases establish that in appraisal proceedings incident to merger, the Engineers preferred stockholders would have been very fortunate if they obtained an award even approaching $100 per share.[4] And the provision in Engineers' charter

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[1] R. 651a-653a; Barnes testified (R. 653a):

"Q. Then would you say the over-riding weight, then [for abandonment of the 'merger' possibility] was the change in tax circumstances? A. I think so. That, and to meet the ideas of the staff and the Commission."

And Benjamin testified (R. 589a):

"You speak of Engineers continuing as a going concern. Even under the merger alternative there was no continuance of the business of Engineers. It is possible that it would have been merged with Virginia but there was no business of Engineers left. The business of Engineers as a public utility holding company would certainly disappear even under the merger alternative."

[2] Statement of Commission Counsel before the District Court, R. 255a.

[3] See observations by Judge Leahy to this effect in his opinion, *In re United Light & Power Co.*, 51 F. Supp. 217, 223. Cf. *Otis & Co.* v. *S. E. C.*, 323 U. S. 624, 637.

[4] It is well settled, for example, that existing market prices are not controlling (*Chicago Corp.* v. *Munds*, 20 Del. Ch. 142, 172 Atl. 452) particularly in a case such as this where the market prices reflected such extrinsic factors as Engineers' concentrated market purchases.

Our research has disclosed only *one instance* in which preferred stockholders were awarded more than the par value plus accrued dividends in an appraisal proceeding. That award was promptly

to which Commission Counsel referred, was obviously intended to *prevent* the preferred holders from receiving as much as their liquidation preference in the event of a merger, not to make possible enhancement of their claims in excess thereof.[1]

This specious "merger" issue raised by petitioners demonstrates once again the vice of their reliance upon a fictional approach to the issues here under consideratrive. Whatever form was adopted, the plan would have had to accomplish the statutory command for the retirement of the preferred stocks, and the effective dis-

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reduced to $100 per share by the New York Court of Appeals in the leading case of *Matter of Fulton*, 257 N. Y. 487. The Court held that the preferred stockholders, in the absence of a charter liquidation preference, should be limited to the amount originally paid for their stock, and should be denied the right to share in the corporation's accumulated surplus, all of which was held to belong to the common stockholders. See also *American General Corp.* v. *Camp*, 190 Atl. 225, where it was squarely held that premiums are not payable in appraisal proceedings. This decision was cited with approval by the Commission in *United Light & Power Co.*, 10 S. E. C. 1215, 1226.

See also: *Root* v. *New York Corporation*, 50 A. (2d) 52 (Del. Ch. 1946), in which preferred stockholders having claimed approximately $200 per share (including redemption premiums), the appraiser's award of $90 per share was upheld by the Chancellor; and in the decision of the Delaware Court of Chancery in *Re General Realty & Utilities Corp.* (52 A. 2d 6 [March, 1947]) the Chancellor allowed $108 per share against a claim of $172 (par plus dividend arrears), stating: "* * * the dreary earning and non-dividend record of this corporation cannot be minimized in valuing the shares as stock in a going concern."

[1] See Engineers' Ex. 33, R. 1413a. It will be noted that it is there provided that a consolidation or merger shall not be regarded as a "liquidation, dissolution or winding-up" within the meaning of the paragraph entitling the preferred holders to their liquidation preferences "*provided such consolidation or merger does not substantially impair the rights and preferences of the preferred stocks*". It is thus plain that in a merger the preferred stockholders could not claim their liquidation preferences unless they could show their rights and preferences had been impaired. Only if they were successful in such a showing could they *receive* the liquidation preference.

solution of Engineers and what remained of its system. As the *Otis* decision teaches, it is less important in what form the plan is clothed than it is to ascertain what it accomplishes. In that case, this Court and the Courts below all stated in effect: You may call your plan a liquidation, but if it accomplishes essentially a mere stock reclassification incident to simplification of a continuing holding company system, we will not apply charter liquidation rights.[1] Similarly, it avails nothing to refer to the Engineers' plan as "a might have been merger", when, in fact, as well as in form, the plan accomplished the complete, authentic and final dissolution of the entire holding company enterprise which the statute commanded. It is this *substantive reality* which must be the controlling factor, and this substantive reality cannot be obscured by specious fictional arguments of the type above discussed.

Equally specious are the suggestions that the preferred stockholders were unfairly treated in being required to accept full payment of their claim in cash, and that they were unable to secure participation "in the flourishing

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[1] Thus, Judge Leahy, in approving and enforcing the United Light plan, stated:

"* * * the Commission has caught the nuance in the present situation. There is no real finality to this particular dissolution. * * * the interests of all classes of stock are nevertheless still lodged in a continuing enterprise. * * *

"It is neither an exercise in semantics nor a rejection of labels to consider the present plan little more than a reclassification. If it had donned the formal dress of reclassification by way of merger, the preferred may have been met with the issuance of a new stock with a reduced dividend rate and a wiping out of its dividend arrearage claim. * * *" (*In re United Light & Power Co.*, 51 F. Supp. 217, 223.)

Cf. *Otis & Co. v. S. E. C.*, 323 U. S. 624, 637.

underlying operating companies". The common stocks of the two operating companies distributed in the liquidation, as well as the stock of Gulf States (sold to the common stockholders for $22,000,000 through the warrants technique) were immediately made available for purchase on the leading stock exchanges; and a large volume of trading forthwith ensued.[1] Any preferred stockholder desiring to exchange the $100 per share in hard cash received by him for a participation in the "future growth possibilities" of the distributed operating companies could freely do so at "bargain prices".[2] He may do so today at

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[1] See our Main Brief, p. 41, note 2; p. 101, note 3.

[2] As we have shown in our Main Brief (p. 118, note 1) the common stocks of the operating companies distributed by Engineers were priced by the market at approximately 8 times their then current annual earnings, and are presently selling, on the average, for approximately 5% less. It may be noted that Badger assumed that they would sell for 15 times annual earnings (Engineers' Ex. No. 29, R. 2072a).

For the $100 in cash received for each share of preferred stock, the former Engineers' preferred stockholder was enabled to purchase shares of the underlying companies *earning $12.50 per annum, as compared with $5.40 average dividend rate formerly received on the preferred stock.* To be sure, the two amounts are not strictly comparable since one represents income from a holding company preferred stock, and the other from the underlying common stock. But the amount allowed by the Commission in allocation plans for such "loss of position" has generally been in the neighborhood of approximately 25%. Thus, the holders of 5% preferred stock of Washington Railway and Electric Company having investment characteristics far superior to those of the Engineers' preferreds (consolidated fixed charges and preferred dividends covered from 2.22 times to 2.96 times over previous eight years, as compared to 1.3 times in the case of the Engineers' preferreds) were held to have received fair and equitable treatment in the form of underlying securities (principally but not entirely, common stock) having an estimated earning power ranging from $6.05 to $6.69 per share of preferred (Washington Railway and Electric Company, Holding Company Act Release No. 7410, p. 26).

Similarly, the holders of well secured 7% preferred stock of Northern States Power Company of Delaware (entitled not only to dividends of $7 per year, but to accumulated arrears of $6.50 per

even lower prices.[1]

The experience of the Commission and the Courts with allocation plans conclusively establishes that senior security holders invariably strongly desire payment of their claims in cash in accordance with the provisions of their charters or indentures, and protest vigorously against an attempt to pay them out in portfolio securities. Cf. *In re Standard Gas & Electric Company*, 59 F. Supp. 274, rev'd 151 F. 2d 326 (C. C. A. 3), *cert. den.* 327 U. S. 796; *In the Matter of Community Gas & Power Company*, 71 F. Supp. 171, aff'd 168 F. 2d 740 (C. C. A. 3), *cert. den. sub. nom. Vanneck* v. *S. E. C.*, 334 U. S. 846. It cannot be doubted that similar vigorous protests would have been forthcoming from the preferred stockholders if Engineers had proposed an allocation of underlying common stocks instead of full payment of their contract claim in cash. It is understandable, however, that petitioners should now seek to imply otherwise, in an effort to justify their demand for an even larger cash payment.

(3) Not only do both the record and the Commission's findings contain nothing to support Commission Counsel's suggestion that the management favored the common stockholders over the preferred, but both the record and

share) were held to have been accorded fair and equitable treatment when they received common stock of the underlying operating company having an estimated earning power of $8.60 per share of preferred (Northern States Power Company, Holding Company Act Release No. 7950, p. 37).

There has never been an allocation plan in the history of the Commission in which senior security holders were held entitled to anything approaching the $12.50 per share of operating company earnings which the Engineers' preferred holders were enabled to acquire in exchange for their former $5.40 dividend rate.

[1] Cf. our Main Brief, p. 101, note 3.

the conduct of the management suggest unequivocally that in fact no such favor was intended or produced. In the first place, the record establishes that the more substantial common stockholders were also among the largest holders of the various classes of preferred stocks [1] and that in some instances their direct financial interests would have been more substantially benefitted by the payment of premiums than by their non-payment.[2] In the light of these facts there is small reason to suppose, as Commission Counsel imply, that the management of Engineers would

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[1] The briefs of Streeter (p. 6) and the Commission (p. 72, n. 43) state that 338 stockholders own some 70% of the common stock, but it is not pointed out that these are *record* owners, among whom are some of the largest brokerage and investment houses in the financial community (see Exs. 43-45, R. 1769a-1770a). These record owners are merely nominees for many individual beneficiaries, and the record establishes (R. 572a, 821a) that there is no way of knowing how many beneficial owners are represented by such record ownership. In any event, it will be noted that Pratt Brothers (the largest record owner of common stock (Engineers' Ex. 43, R. 1769a) is also listed as one of the largest owners of each of the three series of preferred stock (Engineers' Exs. 40-42, R. 1761a-1768a); Brown Bros. Harriman & Co., listed as a large common stockholder, is also one of the largest owners of all three series of preferred (Engineers' Ex. 44, R. 1772a); J. M. Forbes & Co., one of the large common stockholders, was the largest single owner of the $5.50 preferred (Engineers' Ex. 41, R. 1763a); Edwin S. Webster, Frank Jay Gould, and Brown Bros. Harriman, all large common stockholders, were the three largest holders of $5 preferred (Engineers' Ex. 42, R. 1766a). Many similar correlations will be observed.

[2] Thus, Brown Bros. Harriman & Co. owned a total of 4,557 shares of common stock, and 8,129 shares of the preferred of the various series (Engineers' Ex. 44, R. 1772a). The $3,200,000 representing the aggregate of premiums on the preferred was equivalent to approximately $1.70 per share of common stock, or a total of approximately $7,750 on the common shares owned by this stockholder; total premiums on the preferred shares owned by it would have aggregated approximately $66,500.

Similarly, J. M. Forbes & Co. (alleged to be affiliated with "the Stone & Webster interests", R. 568a) owned 19,131 shares of common, 10,295 shares of $5.50 preferred and 340 shares of $5 preferred. Payment of premiums on the preferred would have resulted in pay-

treat lightly, much less ignore, the valid claims of the preferred stockholders in the distribution of the Company's assets on liquidation.

Moreover, the conduct of the management in this proceeding discloses an attitude of complete impartiality as between the two classes of stockholders. Its failure to dispute the Commission's order in the Courts hardly reflects that bias in favor of the common stockholders which Commission Counsel seek to impute.[1] And the fact that respondents, who have been forced to shoulder the burden of this litigation, were successful in both Courts below, suggests that the issues in this case were not so plainly foreclosed that a management more favorably inclined to the views of the common stockholders would not have felt justified in assuming the burden of asserting these claims.

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ment to this stockholder of more than $100,000, whereas non-payment would result in receipt of approximately $32,500.

Similar results are shown for the holding of Amoskeag Corp., C. A. England & Co. and Sigler & Co. In the case of other large common stockholders such as Edwin S. Webster and Frank Jay Gould, although the balance is in favor of non-payment of premiums, the difference is relatively inconsequential when allowance is made for the premiums they would have received on their preferred holdings (Engineers' Ex. 40, R. 1772a *et seq.*).

[1] Engineers notified its stockholders that it did not feel warranted in contesting further the payment of the premiums to the preferred stockholders, on the advice of counsel that "courts are reluctant to override such findings by administrative Commissions" (R. 1937a). That this advice of counsel was predicated solely on his views as to the difficulties of obtaining judicial relief, and not upon any changed view as to the unfairness of the Commission's determination, is established by the record (R. 1957a-1959a).

II. PETITIONERS' CONTENTIONS THAT THE "VALUES" OF THE PREFERRED STOCKS AS DETERMINED BY THE COMMISSION WERE "ADMITTED BY THE COMPANY AND UPHELD BY THE COURTS" ARE NOT ONLY REFUTED BY THE RECORD, BUT THE COMMISSION CONCEDES THAT IT RELIED ON AN "ESTIMATE" OF STOCK MARKET PRICES AS OF A HAPHAZARD MOMENT.

(1) Throughout petitioners' briefs runs the constant refrain that "the Commission determined in accordance with the *undisputed testimony* that the current worth of the preferred, or its 'investment value' on a going concern basis, was at least equal to the respective call prices." [1] We believe we have adequately demonstrated in our main brief (pp. 11-15, 73-86) how mistaken and misleading are such contentions. The representatives of the company stated emphatically and repeatedly that the redemption prices *did not* represent the "investment value" or "fair value" of the preferred stocks on a going-concern basis.[2] The fact that the Commission chose wholly to ignore this testimony in its opinion does not accord petitioners the privilege of denying its existence in their briefs before this Court.

What is even more surprising, however, are the following statements in the Commission's brief (p. 18):

> "* * * both courts below likewise upheld the Commission's determination that the value of the preferred stocks on a going concern basis was at least equal to the amount of the redemption prices.

* * * * * *

[1] S. E. C. Brief, pp. 10, 28. Cf. Streeter Brief, p. 109.

[2] See testimony referred to in our Main Brief, pp. 82-3; and see statement of Engineers' Counsel quoted at p. 82, note 1.

The Commission's findings of present value, which the courts below accepted * * *."

Our examination of the opinion of the Court of Appeals discloses no such "acceptance". On the contrary, we find that Court stated (R. 38):

"The difficulty in sustaining the Commission's position in respect to 'investment value', *even insofar as the Commission has applied that value*, lies in the fact that investment value is and can be only one of a series of factors to be used in arriving at equitable equivalents. We conceive that the Commission could make a finding under certain circumstances that investment value was the equitable equivalent to the security holder. The Commission in the instant case, however, has not made such a finding *and we do not believe that such a finding could be supported on the present record.*" (Emphasis supplied.)

Further evidence that the Court of Appeals did *not* either "accept" or "uphold" the Commission's findings as to values is its statement (R. 19):

"The trial judge also made a *cogent finding* respecting Dr. Badger's use of interest rates as an aid in fixing values for the preferred *deeming the interest rate used by the latter to be too low*. This finding is set out in the margin." (Emphasis supplied).[1]

[1] Petitioners have made oblique attacks (see S. E. C. brief, p. 14, note 12; Home Insurance Company brief, p. 7, note 1) on the findings of the District Court by reason of the fact that a draft of proposed findings was submitted by respondents to the District Court at its request, in accordance with the customary practice of trial courts and other fact-finding tribunals. We make no comment with respect to these wholly unwarranted attacks, other than to point out that the record establishes that the findings as issued by the Court were not in the form submitted by respondents, having been extensively revised by the Court following their submission (R.

The District Court's finding which the Court of Appeals quoted in its opinion (R. 19, note 9) in turn demonstrated how far the District Court was from "upholding" the Commission's determination that "the value of the preferred stocks on a going concern basis was at least equal to the redemption prices". In its opinion, the District Court indicated that it was willing to assume the "values" contended for by Badger because it deemed them irrelevant in the light of the fact that such "values" necessarily reflected elements attributable solely to the liquidation, such as "the retained earnings over a period of years not paid as dividends to the common stockholders" (R. 291a). And in its findings, it again pointed to the fallacious nature of Badger's "values", stating (R. 312a):

> "Assuming the correctness of Badger's estimates of the investment values of the Engineers' preferred stocks 'on a going concern basis'; *subject to all the infirmities above referred to,* the question still is: '*investment values*' for how long?"

In short, the District Court recognized Badger's "values" for what they were: estimates of hypothetical, momentary market prices based on the artificial and transient levels as of the time of Badger's study;[1] and the Court expressly *refused* to accept these "values" as the intrinsic invest-

391a), as petitioners' counsel are well aware. Moreover, the Court ordered the findings as revised by it to be exhibited to all counsel in advance of the hearing, and it accorded a hearing to all counsel who wished to be heard with respect thereto (R. 385a-391a). In addition, the Court agreed to entertain any motions which might be submitted under Rule 52(b) of the Rules of Civil Procedure requesting amendments or supplementary findings, and to hold a further hearing with respect thereto (R. 385a); but no such motions or requests were ever submitted.

[1] "It is thus primarily a market value criterion, and is subject to all the problems inherent in predicting future market values" (Finding No. 42, R. 310a).

ment value of the Engineers' preferred on a going concern basis.[1]

It is thus evident that the Commission's determination of the redemption prices as the "investment values" of the preferred stocks on a going concern basis, far from being "accepted" by the company, and "upheld" and "approved" by both Courts, was rejected by each in turn as representing no more than an irrelevant, artificial and transient market appraisal.

Indeed, the Commission's brief in effect concedes that it represented nothing more. In discussing Badger's values, the brief states (p. 37):

> "Badger reached his result by comparison of current yields of other similar preferred stocks. He concluded that a proper yield basis for the Engineers' preferred was 4.6%. This yield basis represented *his estimate* of *how the investment markets would evaluate* the risk of Engineers' stockholders not receiving their preferential dividends in perpetuity, disregarding both the impact of Section 11 and the redemption price ceilings." (Emphasis supplied.)

Reduced to its essence, what this statement concedes is that Badger did not attempt to express his own "expert" judgment as to the value of the Engineers' preferreds based on their intrinsic merit.[2] Instead, Badger allegedly gave "his estimate" of "how the investment market would evaluate" certain factors "in perpetuity". And, as we have shown,[3] he determined how the market would evaluate these factors "in perpetuity" by the market prices of certain allegedly comparable securities

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[1] Findings Nos. 51-54, R. 313a-315a.

[2] See our Main Brief, pp. 75-6.

[3] Main Brief, pp. 75-9.

on January 4, 1946, without regard to the fact that several weeks or months earlier the market had evaluated these factors very differently.[1]

Moreover, it is, of course, the sheerest nonsense to say that the market price of a stock on a particular day represents the market's evaluation of "the risk of * * * stockholders not receiving their preferential dividends in perpetuity, disregarding the impact of Section 11 and the redemption price ceilings". Market prices on any day reflect an entire congeries of extrinsic factors such as the market's appraisal of what some foreign power may do the next day in Berlin, what action the Government may take in Washington with respect to a dozen different factors (including the prices to which it will "peg" the bond markets), what labor unions will demand at their forthcoming conventions, how the electorate will vote at the polling places, and so forth. And, needless to say, the following day "the markets" may, and generally do, appraise these factors quite differently.

Indeed, it is nothing short of paradoxical that counsel for an expert administrative agency find it necessary to avow that this expert body reached its determination of the "investment value" of the Engineers' preferred stocks on the basis of the "estimate" made by a witness as to how the *markets* would "estimate", as of

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[1] Thus, Badger evaluated "how the market would evaluate" the Engineers' preferreds by using a market price as of January 4, 1946 of $105.50 per share for Columbia Gas & Electric preferred stock. Some months earlier the market's "evaluation" of these factors was reflected in a market price for this very stock of $84 per share (Main Brief, p. 77, n. 1). In similar fashion, Badger used a market price of $114.38 for Public Service of New Jersey preferred which some months earlier had sold for 102⅝, and some time subsequent to Badger's testimony declined to $95 (R. 123). See also the record of sharp price fluctuations of the other securities used by Badger (Main Brief, p. 77).

a given haphazard moment, the value of the preferred stocks' theoretical right to future dividends. We venture to doubt that the "expertise" of the stock market as reflected in its day to day "valuations" is the type of "expertise" which Congress intended should be brought to bear in passing on the "fairness and equity" of plans under Section 11(e).[1]

(2) Brief mention may be made of other statements in connection with the "values" of the Engineers' preferreds which may give a misleading impression. At several points in the Commission's brief it is stated that the preferred stocks were found to have an "asset value" of approximately $200 per share, so that even if adjustment were made for the retained earnings of the common there would have remained substantial asset value for the preferred.[2] But it is not pointed out that Badger

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[1] As we have demonstrated at page 79, note 2, of our Main Brief, the Commission's findings and the record are utterly barren of any other evidence on which the Commission could have based its determination that the preferreds had a "value" equal to the redemption price; and that the few items mentioned by the Commission in its opinion *without comment* all plainly pointed in the direction of a value of less than $100 for the preferreds.

That the Commission relied solely on Badger's estimate of market prices is further demonstrated by the following additional statement in the Commission's Brief (pp. 36-7):

> "But the most workable hypothesis for finding a fair equivalent between cash received and the security surrendered under the compulsion of the plan, is that of reinvestment in a security of comparable risk. *How much money would it cost the preferred stockholders to replace their securities with comparable ones?* This equation was substantially the basis upon which the valuation witnesses testified * * *." (Emphasis supplied.)

It is thus admitted by Commission Counsel that the Commission's rationale in the instant case is predicated on the premise that in a dissolution compelled by the Act, the common stockholders must become the *indemnifiers* of the preferreds' disappointed expectations. And in this case, those expectations were measured solely by market values on *January 4, 1946*, and without regard to any other factor.

[2] S. E. C. Brief, pp. 7, 75, note 45.

calculated this "asset value" merely by taking book figures at face value, and without allowance for inflationary items which regulatory authorities require to be eliminated by amortization or charge off.[1] The record establishes that when adjustment is made for such balance sheet items, the asset value of the Engineers' preferred stocks barely approximated $100 per share.[2]

The Commission's brief admits that the Commission, like Badger, made no attempt to determine the prospective earning power of Engineers on a going concern basis, but argues that the Commission was entitled to rest upon the high earnings of 1945 and 1946.[3] Yet at a later point in this same brief, in discussing the earnings of Puget Sound for the same years to which the Courts below made reference, it is stated (p. 61):

> "* * * it would seem presumptuous to assume that earnings for those two years will represent an average for the system upon which interests in the enterprise should have been allocated."

We think this second contention is a sufficient answer to the first. If the high earnings of the war and immediate post-war period are not acceptable for determining the

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[1] R. 1096a-1102a.

[2] Engineers' Ex. No. 77, R. 1851a. It is to be observed that similar adjustments in the accounts of the five holding company preferred stocks used by Badger for "comparative" purposes established that their asset values were from 25% to 200% higher than those of the Engineers' preferreds. (Ibid.)

Cf. 10th Annual Report of the Securities and Exchange Commission, pp. 72-3: "Elimination of Inflation in Plant Accounts."

[3] S. E. C. Brief, p. 10, note 7; pp. 35-39.

fairness of an allocation plan under Section 11(e), there certainly was no valid basis for the Commission to rest on them here in determining the "rights" of the preferred stockholders unilaterally; and all the more so in the face of Barnes' warnings that "we are in a boom period" (R. 667a) and that "much of the present market value [of the Engineers' preferred stocks] was attributable to the sacrifices made by the common stock and to war earnings" (R. 630a).[1]

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[1] See our Main Brief, p. 95, n. 1, with respect to the reduction which has already taken place in the earnings of Virginia, the principal asset distributed to the common stockholders in liquidation.

Cf. *Group of Institutional Investors* v. *Chicago, M., St. P. & P. R. Co.*, 318 U. S. 523, 543:

> "We cannot assume that the figures of war earnings could serve as a reliable criterion for that 'indefinite future'. As some of the bondholders point out, the bulge of war earnings *per se* is unreliable for use as a norm unless history is to be ignored; and numerous other considerations, present here as in former periods, make them suspect as a standard for any reasonably likely future normal year."

III. PETITIONERS' CONTENTIONS AS TO THE IRRELEVANCE OF THE RETAINED EARNINGS OF THE COMMON STOCKHOLDERS, PAST MARKET HISTORY OF THE PREFERREDS AND THE LOSSES SUSTAINED ON DIVESTMENTS, ARE ERRONEOUS AND IN CONFLICT WITH THE RECORD.

A. Contentions as to the earnings of the common stockholders retained to provide for the compulsory liquidation.

In its opinion [1] and findings [2] the District Court gave consideration to the accumulated earnings of the company withheld from the common stockholders to provide for the compulsory liquidation of the enterprise and the retirement of the preferred stocks. It pointed out that these large amounts had an important bearing on the "values" of the preferred stock at the time of liquidation,[3] a factor to which neither Badger nor the Commission accorded even the slightest consideration. Petitioners now contend that this factor was entitled to no consideration, because, contrary to the District Court's findings, the withholding of dividends was motivated solely by narrow self-interest on the part of the common stockholders stemming from tax considerations. Even more, the Commission's brief states that Engineers' witnesses "freely conceded"

[1] R. 291a.

[2] Findings 35-36, R. 306a-307a; Finding 47, R. 312a.

[3] Ibid.

this to have been the case.[1] Commission Counsel's statement is contrary to the evidence, and the entire contention is devoid of merit.

(1) In the first instance, it may be observed that this contention contravenes not only the findings of the District Court as to the reasons why dividends were withheld from the common stockholders (R. 291a, 307a), but those of the Commission itself. In its findings and opinion the Commission found:

> "The management has pursued a policy of withholding dividends on the common stock until it is satisfied that the system has made all the adjustments that will be required of it under the Holding Company Act" (R. 69a).

It then added by way of a footnote:[2]

> "No dividends have been paid on the common since 1932, although earnings have been available since 1938".

It seems strange that the Commission itself should thus have found upon the record that the management withheld dividends from the common stockholders so that the system could make "all the adjustments that will be required of it under the Holding Company Act", whereas Commission Counsel now tell us that the record establishes something quite different. We shall show that the

[1] S. E. C. Brief, p. 72:

"In the first place, Engineers' witnesses freely conceded that they regarded it as in the interest of the common stockholders, from the point of view of minimizing Federal income taxes, to avoid receipt of dividends and instead to build up the equity value of the common stock upon which they might realize through capital gains taxable on a more advantageous basis than dividends."

[2] Note 53, R. 69a.

truth lies with the findings of the Commission and the District Court.

The alleged "concessions" of "Engineers' witnesses" to which the Commission's brief purports to make reference (*supra;* p. 29, note 1) had no relation whatever to the subject of the retained earnings and the management's dividend policy during the ten year period 1935-1945 dealt with in the findings of the Commission and the District Court. The testimony of one witness discussing a phase of the original Engineers' plan as it might affect stockholders in 1945, has been wrenched from its context and distorted.[1] This is in effect disclosed by the footnote which is appended to the text statement (S. E. C. Brief, note 43, p. 72).

This same witness, Benjamin, specifically and repeatedly testified that the management's policy of withholding dividends from the common stockholders over the eight year period antedating the final plan was impelled by the necessity of providing for the liquidation required by the Act (which at first it had been hoped would be only partial, but which later was found must be complete) including the compulsory retirement of the preferred stocks. He testified (R. 577a):

> "* * * the directors of Engineers have adopted a policy of not declaring dividends on the common stock because of the uncertainties due to the Holding Company Act.

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[1] Engineers' plan as originally filed with the Commission contained a provision that the common stock of Virginia would not be distributed by Engineers until the remaining phases of the liquidation had been carried out, a period estimated not to exceed three years. Benjamin, secretary of Engineers, testified the management felt that even though this provision of the plan would delay distribution to the common stockholders of this one asset, it was not felt this delay should prove unduly prejudicial to the common stockholders, considering the high taxes on personal income then prevailing (1945, the last year of the war) as compared with the more favorable treatment which they might realize as a capital gain (R. 459a).

Q. (by Commission Counsel). What do you mean by that exactly? A. Well, the future of Engineers has been uncertain because of the requirements of the Public Utility Holding Company Act requiring divestment, and so forth, and the orders of the Commission that have been issued and pending the final work-out of the Plan, this money has been kept in the system rather than having been paid out.

Q. Are you trying to say in effect that the money was being kept in in order to pay out the preferred stockholders? A. That is what the money is going to be used for.

Q. Is that the reason why it wasn't paid out in dividends? A. Yes, I think that was one of the principal reasons".[1]

Benjamin further testified (R. 724a):

"* * * I think the directors felt that, from the discussions that I have heard among them, the preferred stockholders were entitled to receive the

[1] With respect to the manner in which these funds accruing to the interest of the common had benefited the preferred, Benjamin testified (R. 470a):

"A. This shows that the total cash accruing in the system to the interest of Engineers Common Stockholders and not distributed during this period was approximately $24,500,000. Not all of these earnings would have been available for distribution because of restrictions on dividends in some of the subsidiary companies, but the accumulation of these funds within the system because of the requirements of the Public Utility Holding Company Act has added materially to the value of the Preferred Stock because the funds, together with funds derived from the sale of properties, have been used in part to finance improvements and additions which have increased the earning power of the subsidiaries and in part to retire 60,346 shares of Preferred Stock of Engineers and El Paso of Delaware combined, at an aggregate cost of $5,894,227, thereby improving the security of the presently outstanding Preferred Stock. At June 30, 1945, Virginia, Gulf States and El Paso had $2,773,000 of free earned surplus and Engineers, the parent company, had $7,095,000 of free earned surplus or a total of $9,868,000 which could have been declared out in Common Stock dividends. If this amount had been paid out in dividends the consolidated Common Stock and Surplus ratio would have been reduced from 16.13 percent to 12.6 percent."

amount to which we referred before [$100 plus accrued dividends] and that could be paid off in cash and *that the common stockholders should forego any dividends until the obligation to the preferred stockholders had been satisfied*". (Emphasis supplied.)

Finally, in response to a direct question as to whether tax considerations had played a significant role in the management's policies with regard to withholding dividends, he stated (R. 920a):

> "I think that the management and possibly the directors too realized what the effect would be on the large stockholders in withholding dividends; but *I think the primary reason for withholding dividends was to accumulate in the system the funds to take care of the preferred stock.*" (Emphasis supplied.).

We submit that there is nothing in the foregoing testimony which justifies Commission Counsel in implying that Engineers witnesses conceded that the withholding of dividends from the common stockholders was motivated by the purpose of "minimizing Federal income taxes to avoid the receipt of dividends * * * ".[1] And Barnes, the only other Engineers' witness who testified on this subject, likewise affirmed that the dividends were withheld "because of the uncertainties in connection with what would have to be done under the Public Utility Holding Company Act * * * " (R. 973a).

It is thus evident that in this instance once again, as in the others heretofore discussed, Commission Counsel's present attempt to write an entirely new set of "findings"

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[1] So far was the Commission itself from agreeing with the contention here advanced by its counsel, that it based its conclusion as to the "benefits" which the common would derive from the retirement of the preferred upon the fact that " * * * *it hastens the day when the common will begin receiving dividend income*" (R. 69a). (Emphasis supplied.)

in their brief cannot prevail where such proffered "facts" contravene the clear evidence in the record, as well as the formal findings made with respect thereto by the District Court and by the Commission itself.

(2) The significance of withholding earnings from the common stockholders in order to meet the command of the statute is not that the common stockholders are entitled to commendation for their forbearance. Its significance is that the District Court was warranted in ruling that basic considerations of fairness required these withheld earnings to be recognized as contributing to the "value" of the preferred stocks in determining whether the common stockholders should be required to pay premiums to the preferred.

Although the Commission had not formally prohibited Engineers from paying dividends to the common stockholders, the statutory command to retire the preferred in the course of either partial or full liquidation placed Engineers in a position such that it would have violated every sound corporate and accounting practice if dividends had been paid to the common stockholders prior to the retirement of the preferred stocks or setting aside assets to meet their claims.[1]

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[1] Petitioners seek to argue that only some $10,000,000 of these retained earnings consisted of "free surplus" available for payment of dividends, and that the decision to retain these earnings was a matter of voluntary choice on the part of the common stockholders. But, viewed on any realistic basis, it is indisputable that the operation of the statute dictated retention of the entire $24,552,182 of common stock earnings. From the time of its registration under the Act, Engineers was not a free agent on major policy questions except in such matters as the Commission and its staff might see fit to permit. Thus, approximately $14,500,000 of the common stockholders' earnings referred to above, was "frozen" pursuant to accounting adjustments and indenture provisions which were necessary to meet the Commission's routine requirements as a condition precedent to its approval of various transactions, such as refinanc-

These earnings of the common stockholders thus having accrued while Engineers was in effect *in custodia legis,* it would be even less fair and equitable to add them to the "value" of the preferred stocks upon which the common stockholders are then required to pay premiums, than was the claim for double interest which this Court disallowed in *Vanston Bondholders' Protective Committee* v. *Green,* 329 U. S. 156, stating (pp. 165-167):

> "It is manifest that the touchstone of each decision on allowance of interest in bankruptcy, receivership and reorganization has been a balance of equities between creditor and creditor or between creditors and the debtor * * *. A Chapter X or Sec. 77B reorganization court is just as much a court of equity as were its statutory and chancery antecedents * * * (p. 165).
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> * * * first mortgage bondholders would have been enriched and subordinate creditors would have suffered a corresponding loss, because of a failure to pay when payment had been prohibited by a court order entered for the joint benefit of debtors, creditors, and the public. *Such a result is not consistent with equitable principles.* For legal suspension of an obligation to pay is an adequate reason why no added compensation or penalty should be enforced for failure to pay" (pp. 166-167) (Emphasis supplied).[1]

ings. None of these restrictions existed prior to the Act or apart from it. Likewise, although the management of Engineers made no attempt to declare out the $10,000,000 of "free surplus" as dividends to the common stockholders, this decision resulted from the circumstance that from the date the statute became effective, Engineers was confronted with the necessity of liquidating either entirely or in substantial part (depending on how drastically the Commission construed Section 11's application to the Engineers system).

[1] Cf. statement of Commissioner Healy, dissenting in *American Power & Light Co.,* Holding Company Act Release No. 6176 (1945), at pp. 57-58:

"It seems apparent that the strong current position which the majority opinion relies on heavily in arriving at its decision

B. Contentions respecting losses on divestments.

Commission Counsel contend that the Courts below erred in attributing relevance to the losses sustained by Engineers in carrying out those steps in the compulsory liquidation which preceded the filing of the plan for final dissolution. In addition, they unloose a broad barrage of objections[1] which run the gamut of suggesting (a) that there were not in reality any losses; (b) that in any event, such losses may have been offset by countervailing gains; (c) that giving consideration to the existence of these losses involves a "collateral attack" on the Commission's determinations in other proceedings; (d) that such consideration requires the Commission to "reconstitute the enterprise" and compute in "dollars and cents" the effect of such losses, an administratively impracticable task; (e) that in any event such a process involves "shifting to the preferred stockholders all or a portion of the losses". It is our position that these contentions are, one and all, devoid of the slightest merit, and that they constitute an attempt to throw a smoke screen over a phase of the Courts' findings which petitioners find particularly troublesome.

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mainly resulted from the retention of earnings. To whatever extent the present strong position of the debt is attributable to earnings and asset coverages that exist because of past sacrifices on the part of the stockholders, it seems to me wholly unfair and inequitable now to penalize them further for this conservatism by requiring them to pay a premium to the debtholders whose contract has been punctually observed at all times '*From him that hath not shall be taken away even that which he hath*'." (Emphasis supplied.)

[1] See S. E. C. Brief, pp. 52-69.

(1) Petitioners' criticisms of the Courts for having found relevant the losses sustained in carrying out the liquidation required by the Act—a subject which petitioners characterize derisively as "weighing colloquial equities"—comes with poor grace from those whose entire argument for the payment of the premiums was based on the contention that the Courts should, in fairness and equity, allow the preferred stockholders to receive $3,200,000 more than their contractual claim, based on alleged values "ex the Act", or "apart from the liquidation required by the Act". When Courts are asked to disregard contractual limitations in order to reach results alleged to be *more equitable,* they can scarcely be asked to function with one eye blindfolded and the other half shut. Only recently Mr. Justice Murphy had occasion to emphasize this principle in the context of a corporate reorganization, stating: "*Equity looks in all directions.* Only in that way can the various interests in the corporate community be adequately protected".[1]

As we have shown in our main brief (103-105) the Courts below correctly grasped the inconsistency which pervaded and distorted the Commission's rationale in this case. The preferreds' rights were viewed as though the Act did not require liquidation—indeed as though the Act did not exist. However the common's rights were viewed merely as those of the residual claimants in the liquidation which the Act had in fact compelled, and in consequence of which, losses and deprivations had been sustained by the company and the common stockholders for many years.

The liquidation of Engineers did not commence with

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[1] *Comstock v. Group of Institutional Investors,* 335 U. S. 211, 238 (Emphasis supplied). See also p. 107, note 1 of our Main Brief.

the filing of the plan which is the subject of the instant proceedings; it merely ended there.[1] Throughout the long period during which Engineers has, under the compulsion of the Act, divested itself of valuable subsidiaries, frozen its liquid assets, and denied its common stockholders a share in its earnings, the preferred have been insulated from all contact with such realities. The common stockholders have been forced to bear the consequences of the shocks and dislocations which enforcement of the Act has imposed upon the company. Now, in the final stages of the liquidation, the Commission has imposed upon the common stockholders an added burden—to compensate the preferred for the loss of their claimed *future* high expectations "as though there were no liquidation and no Act".

We do not suggest, nor did the Courts below, that the common stockholders should be compensated for the unhappy consequences which the compulsory liquidation of Engineers visited upon the common stockholders over the past ten years. We do submit, however, that the common stockholders should not be compelled in addition to pay premiums to the preferred for their allegedly disappointed *expectations*; and that therefore the Courts below were wholly correct in holding that fairness and equity require that there be taken into consideration the frustration of

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[1] The Commission's brief (p. 48) criticizes the Court below for failing to apprehend that the "shorthand expressions 'apart from the Act', or 'ex the Act' must be read with the interpolation 'ex [the present reorganization required by Section 11(b) of] the Act'." But the Court was not under any *misapprehension* of what the Commission contended: its point was that which has been stated above in the text, namely, that there is neither logic nor equity in ignoring the stages in the compulsory liquidation of the enterprise resulting from the Commission's divestment orders under Section 11(b), which preceded the *final* dissolution embodied in the plan itself.

the common stockholders' interest, in evaluating the alleged frustration of the preferreds' expectations. To fail to do so would visit "on one class" the consequences of the Act, "with a corresponding wind-fall" to another. (*Otis & Co. v. S. E. C.*, 323 U. S. 624, 637.)

(2) That petitioners are not insensitive to the relevance of these considerations, despite their professions to the contrary, is suggested by the assiduity with which they have sought to obscure and becloud the deprivations and losses sustained by the common stockholders. It is suggested at the outset that such losses are "negatived" by the fact that Engineers' common stock had attained a higher market price in 1946, prior to liquidation, than that at which it had sold during the depression years.[1] Such an argument is as irrelevant as it is specious; for it would be very difficult to name the stock of any company, whether utility or industrial, which did not sell in the post-war boom markets of 1945-1946 at far higher prices than those prevailing during the depression of the 1930s. Not a few, indeed, sold as high ~~or~~ higher than they had sold in 1929, instead of at 40% of their 1929 highs as is true of Engineers.[2] Yet from that fact alone it could scarcely be argued with any validity that these companies could not have sustained financial losses in the intervening period.[3]

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[1] S. E. C. Brief, p. 55.

[2] See District Court Finding No. 31, R. 305a.

[3] The Commission's brief "concedes that it is impossible to demonstrate the relationship between this increase [in market price] and the statute" (p. 55) but nevertheless seeks to imply that there is such a relationship. It may be observed, however, that the improvement in the market price of the Engineers' common manifested a much more significant correlation with the armaments program than with the Holding Company Act. Thus, in 1942, after having had the beneficent effects of the Act for a period of years,

Petitioners next argue that the Courts below were not warranted in finding any relationship between the losses sustained by Engineers in making divestments, and the fact that such losses were sustained in the course of complying with the Commission's divestment orders.

It is asserted, for example, that the approximately $33,000,000 loss sustained by Engineers in connection with Puget Sound is attributable to the fact that this was an ill-advised investment.[1] However, the Courts did *not* base their conclusions on the mere fact that a book loss had been sustained on this divestment, but on the indisputable fact that, absent the compulsion of the Act, a drastic Section 11 reorganization of Puget Sound would not have been forced upon Engineers at a time when Puget Sound's earnings were vastly lower than they were when Engineers made its investment, and vastly

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Engineers' common sold at a low of 1¼ (Moody's Public Utilities, 1946, page a. 71) approximately the same low figure referred to in the Commission's opinion and its brief as having prevailed in 1935, prior to the operation of the Act. Its entire market increase took place during the four war years, 1942-1945, the same years in which the preferreds rose from lows in the 40's to cross $100 per share (ibid.). During the same period the Dow-Jones index of industrial stocks (not subject to the Holding Company Act) rose from a low of 92 in 1942 to a high of 195 in 1945 (Barrow's Chart of Dow-Jones averages); Dow-Jones index of utilities rose from 10.58 in 1942 to 39.15 in 1945 (ibid.), Standard & Poor's index of investment companies rose from 41.5 in 1942 to 215.7 in 1945 (Investment Weekly Index averages, Standard & Poor's Price Index Record, p. 82).

[1] It has never been questioned, and the record affirmatively establishes, that the cost to Engineers of its investment in Puget Sound was $34,000,000, and that this cost resulted from a completely *bona fide* arms-length transaction. Indeed, the record establishes that approximately $13,000,000 of Engineers' $5.50 series Preferred Stock was issued to former holders of the common stock of Puget Sound in exchange for their equity holdings in Puget Sound (Engineers' Ex. 37-P, R. 1664a). It would thus seem that these preferred stockholders speak with poor grace in reproving Engineers for this "ill-advised" investment (Cf. Streeter Brief, p. 122).

lower than they were by the time of Engineers' liquidation.[1] The District Court noted that it had before it a formal offer of proof proposing to establish "that the equity owned by Engineers in Puget Sound prior to the recapitalization would presently have a cash value of $10,000,000"[2] as compared with the mere $775,000 which Engineers realized upon the sale of its interest in compliance with the Commission's divestment order.[3]

Commission Counsel's conjecture that "it appears probable that good business management would have compelled, at some time, the recapitalization of Puget",[4] does not permit escape from the fact that, if not for

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[1] The Commission's decision is set forth in *Puget Sound Power & Light Co., et al.*, 13 S. E. C. 226 (1943). It will there be seen that the Commission allowed an allocation to Engineers of only 3% of Puget's new common stock in exchange for its surrender of ownership of 99.3% of the former common stock. This allocation was based on the Commission's determination that the foreseeable future earning power of Puget available for the stocks was somewhere between $2,657,000 and $3,083,000 (pp. 243-244 of the Opinion). As the Court below noted (R. 37), actual earnings for the stock of Puget Sound in 1946 were $5,352,000; and for the 12 months ended June 30, 1947, were $5,067,000.

[2] District Court Finding No. 37, R. 307a.

[3] In our reply brief in the District Court respondents stated (p. 42): "* * * we are impelled at this time to make, and hereby do make, *a formal offer of proof* to establish the foregoing facts by competent and authoritative evidence" (emphasis in original). It was further pointed out that "a supplemental hearing for the reception of such proof need not cause prejudicial delay * * *."

The District Court found it "unnecessary for present purposes" to determine this loss with exactitude (Finding of Fact No. 37, R. 307a) but merely judicially noticed that on the basis of the increased earnings of Puget over those estimated by the Commission, and the subsequent rise in the market prices of utility securities referred to by the Commission itself in its annual reports, Engineers' investment in Puget Sound came to have a realizable cash value substantially higher than that realized by Engineers in consequence of the reorganization and subsequent disposition dictated by the Act. We submit that such a finding is axiomatic, and errs, if at all, on the side of conservatism.

[4] S. E. C. Brief, p. 61.

the Act, Engineers would have been wholly free to retain intact its holdings in Puget Sound until such time as it deemed advantageous for recapitalization or sale; and on that basis the record establishes Engineers could have realized approximately $10,000,000 for the interest in Puget Sound which it was required under the Act's compulsion to surrender for $775,000.

Petitioners' attempts to place emphasis on the statement in the Commission opinion that "in all its divestments Engineers has been free in its choice of methods, and within limits to choose the time of divestment",[1] merely highlights the Commission's attempt to pass lightly over the significant phrase "within limits". As we pointed out in our main brief (p. 61, note 1), those "limits" are stringent indeed. Engineers was ordered by the Commission on July 22, 1941, to dispose of its entire interest in Puget Sound "within one year (see *Engineer's Public Service Company*, 9 S. E. C. 764, 797) and similar orders were issued in 1942 requiring divestment of all assets other than Virginia (12 S. E. C. 41). After one year from the date of the Commission's various divestment order, if not complied with, Engineers was subject to drastic penalties.[2]

We do not quarrel with the propriety of those various orders or with the statutory policy which engendered them. We contend, however, that the effect of those orders in the economic circumstances in which the country and the company found themselves during the years in question, was to impose upon the company losses which it would not otherwise have sustained, and that while the common stockholders must bear the burden of those frustra-

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[1] S. E. C. Brief, p. 55.

[2] See Section 11(d) of the Act.

tions they should not also at the same time be saddled with the added obligation of fulfilling the most roseate expectations which the preferred might have enjoyed if the Act had not compelled liquidation. If the preferreds' frustrated "expectations" (which, in any event, as we have shown—Main Brief, pp. 72 et seq.—rested upon a wholly illusory view of continuance of the low money rates current in the early part of 1946) are to be regarded as relevant, then, as the Courts below held, consideration must also be given to the losses and deprivations which the common had sustained in carrying out the earlier phases of the liquidation and the additional ones which the final liquidation has imposed.[1]

Commission Counsel's further contention that Engineers could have distributed to the common stockholder valuable assets such as the stock of El Paso Natural Gas Company of which it was also required to divest itself,[2] is another bald conjecture which cannot withstand examination. At the time Engineers was required to dispose of the El Paso stock, it was not yet determinable whether Engineers would be required to liquidate in whole or merely in part; consequently, no distribution could be made to the common stockholders until this basic issue was determined and "a comprehensive plan" was evolved and approved by Commission and Court for meeting the claims of the senior security holders. In point of fact, Engineers offered El Paso Natural Gas stock to the *preferred* stockholders in a voluntary exchange proposal, which was unsuccessful.[3]

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[1] Main Brief, pp. 114 *et seq.*

[2] S. E. C. Brief, pp. 65-6.

[3] R. 517a.

It is also contended that the argument with respect to losses on sales of security "presupposes a management so prescient that it will sell at the peak of the market" (S. E. C. Brief, p. 65). But this is a palpable misstatement of the issue. These are not sales which the company made willingly, or in the exercise of managerial judgment. On the contrary, it was repeatedly testified that the management viewed with great optimism the future growth possibilities of the El Paso Natural Gas Company, and would not have parted with this asset or the others, if not for the compulsion of the statute.[1] In that event, the company would have had the benefit of the greatly augmented earnings so long as it retained the assets, or in the alternative it would have realized the much higher prices if it ultimately elected to sell in favorable markets, free from pressure. Invidious references to "hindsight" (S. E. C. Brief, p. 58) merely obscure the fundamental issue. The point is not that "hindsight" shows the Commission to have erred in connection with its earlier Section 11 orders such as the recapitalization of Puget Sound, but that the common have in fact sustained demonstrable losses and deprivations in consequence thereof, and that these factors must be taken into account if consideration is to be accorded to the preferreds claimed "deprivation".

(3) Petitioners attempt a further argument that the losses should be offset by nebulous "tax advantages",[2]

[1] R. 508a-510a, 519a, see discussion of the tremendous growth of the El Paso Natural Gas Company at p. 118, note 3, Main Brief.

[2] The only "tax advantage" mentioned is a suggestion in the S. E. C. Brief (p. 62, note 39) that Engineers was able to utilize $2,000,000 of its loss in Puget Sound to realize possible tax ad-

and by the "advantages" accruing from the one acquisition (in connection with Virginia) which Engineers was permitted to make during the ten years it was under the Act.[1] But the record in no way establishes that a profit has resulted, or will result, therefrom. And even assuming *arguendo* that some gain may ultimately result, the fact is that *the Act* did not confer upon Engineers a right to purchase additional properties; that right Engineers previously had without any restrictions whatever. Indeed, the net result of the Act's operation has been to

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vantages. Assuming, *arguendo,* that this offset the loss to the full extent of the $2,000,000 deducted, this would reduce the net loss on Puget to the "inconsequential" sum of $31,000,000. Further, the record establishes that the dividends received by the preferred stockholders in 1944 were considered non-taxable to them because of the drastic capital loss sustained by Engineers on Puget (R. 1606a).

[1] Petitioners' blatant efforts to magnify this transaction by suggesting that net utility property of some $39,000,000 was acquired for "net cash contributions on Engineers' part totalling $3,835,000" (S. E. C. Brief, p. 74, note 44) must be weighed in the light of the failure to mention that Virginia was further required to issue some $32,000,000 of new bonds and notes, and approximately $10,000,000 of additional preferred stock, all of which ranked ahead of Engineers' investment as holder of Virginia's common stock. See *Virginia Electric and Power Co.,* Holding Company Act Release No. 5021, p. 15.

Similar examples of unwarranted inferences and wholly incorrect figures are to be found in Streeter's brief. For example, it is there stated (Streeter brief, p. 122) that "The company's assets as of January 3, 1945 aggregated $65,765,904 * * * as compared with assets in 1938 of only $60,909,703", for the evident purpose of implying that the Engineers system was larger after the divestments than before. The misleading nature of these figures is indicated by the fact that they fail to give effect to (a) a reserve in the amount of $35,000,000 which had been set up on the 1938 balance sheet (R. 1525a); (b) the increase in capital and earned surplus by approximately $9,000,000, representing a portion of the earnings applicable to the common stock which had been accumulated in order to provide for the liquidation of the corporation (R. 86a and R. 1525a); (c) decrease in investment account from $92,862,000 to $52,328,000 (representing assets liquidated) and corresponding increases in cash and cash items representing the proceeds of liquidated assets and retained earnings. More-

prevent Engineers from acquiring any further properties with the proceeds realized from the compulsory sale of its subsidiaries, as we have previously shown.[1]

All the foregoing arguments are plainly advanced by counsel for the Commission in an effort to impress the Court with the difficulties imposed by the alleged requirement of the Court of Appeals that "the Commission must compute in dollars and cents the extent that the over-all impact of the Holding Company Act, or at least Section 11 thereof, may have been harmful to Engineers' common stockholders * * *" (S. E. C. Brief, p. 54). This entire line of argument rests upon an overly ingenuous interpretation of the Court of Appeals' language. The Court did *not* state that such items must be "computed", but merely that they must be "weighed into the calculation", a phrase which, along with the term "bookkeeping", was obviously intended figuratively and not literally.[2] It is thus evident that the Court had no intention of insisting upon the exact ascertainment and computation of each loss sustained by Engineers, but merely upon giving

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over, reference to the *corporate* balance sheet to measure the shrinkage in the system is itself misleading, since the system picture can only be gauged on a combined or consolidated basis. As of December 31, 1935 (the year in which the Act was passed) the consolidated assets of the Engineers system totalled $363,825,581 (R. 1475a). In contrast, the combined capitalization of Virginia and El Paso (the two companies whose common stocks were distributed to the common stockholders as a liquidating dividend) aggregated $136,343,500 (R. 31a, 37a), of which the common stocks received by Engineers' common stockholders had a book value of less than $30,000,000 (*ibid.*).

[1] See note 1, p. 121 of our Main Brief.

[2] "* * * if the equitable equivalents for relinquished securities are to be arrived at by the Commission under the doctrine of the Otis & Co. case, *ex* the Act, losses of the sort referred to in this paragraph must be weighed into the calculation; i.e., such losses should be returned to the credit side of the enterprise's balance sheet as a matter of bookkeeping" (R. 37).

reasonable consideration to the fact that such losses (without necessity for precise computation) had been sustained. Moreover, the Court emphasized that even this relatively simple task was not mandatory upon the Commission unless, despite the final termination of the enterprise, it insisted upon evaluating the rights of the stockholders "ex the Act" (i.e., "apart from the impact of liquidation") in order to compensate the preferred stockholders for their theoretical "disappointed expectations".

That Commission Counsel have greatly exagerated the complexity of this task is further demonstrated by the Commission's recent decision in *Pennsylvania Edison Company*, Holding Company Act Release No. 8550 (October 16, 1948), where the Commission, although noting its disagreement with the Court of Appeals in the *Engineers* case, nevertheless gave consideration to the various factors which the Court held should be weighed. It apparently found no difficulty in discussing and evaluating these factors in several short paragraphs of its opinion (p. 42, note 45).

(4) The final contentions of Commission Counsel, to the effect that (a) according consideration to the losses imposed upon the common stockholders in carrying out the liquidation would involve a "collateral attack" upon consummated reorganization p[la]ns such as that of Puget Sound, and (b) such considera[tio]n would result in shifting "from the common stockholders to the preferred all or a portion of the losses" (S. E. C. Brief, p. 68), seem to us so patently devoid of merit as to scarcely justify discussion. The legality of the Commission's order in the Puget Sound reorganization is in no way questioned.

To take note of the fact that the investment of Engineers in Puget Sound was virtually wiped out in a reorganization indisputably imposed solely by Section 11 of the Act, is not to make a "collateral attack" upon an "adjudicated question"[1] any more than Engineers' auditors made such a "collateral attack" when they recorded the resultant loss in notes to the corporate balance sheet.[2] To take note of the fact that for the common stockholders liquidation under the Act had been an unblinkable reality for more than ten years—when preferred stockholders demand payment of premiums aggregating $3,200,000 as the equitable equivalent of their rights "apart from the impact of liquidation"—is not to shift losses from the common to the preferred, but merely to prevent the imposition upon the common of additional burdens on the theory that the existence of the Act and its requirement for complete liquidation should now be ignored.

C. Contentions as to past market and dividend history of the preferred stocks.

Commission Counsel's airy dismissal of the past market and dividend history of the preferred stocks as bearing on their "investment value" is in sharp contrast with the Commission's decisions, both prior and subsequent to its decisions in the instant case, invariably have emphasized the past market and dividend history of the senior security being retired by payment of cash. Thus, in approving the retirement of the 5½% debentures, and the

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[1] See Streeter Brief, p. 121: "Furthermore, such re-examination is contrary to the policy underlying the doctrine of *res judicata* * * *."

[2] Cf. Engineers' Ex. 37-K, R. 1608a.

$5, $6 and $7 preferred stocks of Cities Service Power & Light Corporation, all of which had currently been selling at or above par, the Commission stated:

> "The debentures and preferred stock of Power & Light have never been high grade securities. They were issued at discounts, and between 1931 and July, 1943, the market price never reached 100. Their ratings in the financial services since their issuance indicate that they have uniformly been regarded as speculative securities. * * *" [1]

And far from indicating that there was any question as to the likelihood of these securities continuing to receive their well secured interest and dividend payments if they remained outstanding, the Commission specifically referred to the possible subordination of certain parent company claims which would "tend to diminish the risks attached to the similar securities held by the public" (Id., at p. 17). The Commission nevertheless concluded that "*the equitable doctrines involved* would not require the payment of the redemption premiums under the circumstances of this case" (Ibid.; emphasis supplied). Similar discussions of past market and dividend history are to be found in literally dozens of Commission decisions under Section 11(e),[2] and the Commission has invariably found such histories significant as bearing on the fairness and equity of the refusal to allow premiums. For example,

[1] *Cities Service Power & Light Corp.*, Holding Company Act Release No. 4944, at p. 16; see also quotation from the same opinion set forth *supra*, p. 6, n. 1.

[2] See, for example, the decisions collated in our Main Brief, page 55, notes 3 and 4.

in the *Interstate Power Company* decision submitted to Judge Leahy for enforcement only a few weeks prior to the Engineers' plan, the Commission held that owners of *first mortgage 5% bonds* of a public utility operating company were entitled to receive only the par value, notwithstanding that the bonds had been selling at a premium of 3½ points above par, the Commission stating:

> "The bonds were originally sold to the public in 1927, 1928 and 1931 at prices of 97½, 96 and 88 respectively. During most of the years since issuance, the bonds have sold on the market at prices substantially less than par; indeed the bonds never sold as high as par until 1945. In 1937 the bonds sold as low as 32; and as recently as 1940 they sold at a low of 51½. At original issuance and sale of the bonds in 1927, a rating A was assigned them by Moody's Investors Service; Standard Statistics rated them B1+. In following years, both ratings were successively lowered to a Moody's rating of B in 1938 and all subsequent years, and a Standard's rating of C1+ in 1940 and all subsequent years." [1]

Yet the very same factors pointing to an even more speculative caliber for the Engineers' preferred [2] were wholly

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[1] *Interstate Power Company,* Holding Company Act Release No. 7143 (p. 21, n. 25) (Jan., 1947), approved and enforced 71 F. Supp. 164 (D. C., Del., 1947); cf. also *Lehigh Valley Transit Company,* Holding Company Act Release No. 8445 (August 18, 1948).

[2] Thus, in order to sell the Engineers $5 and $5.50 preferreds in 1928 at prices comparable to those of the Interstate Bonds, it was necessary to attach warrants and conversion rights (since expired) having a substantial independent value. The Interstate Bonds were never in default of interest; the Engineers preferreds were in arrears of dividends over a period of four years, during most of which the dividends were not even earned. The Engineers preferreds sold as low as $10 per share in 1933, as low as $14 per share in 1935; and as recently as 1942 sold as low as $40-47 per share (R. 1391a-1393a). They never attained par until 1944, when large scale market purchases

ignored by the Commission in its decision; and petitioners now seek to contend that the Courts below have gravely erred in deeming such factors entitled to consideration.

Finally, it may be observed that it is recognized as fundamental among authorities in the field of security analysis that the past market and dividend record of a security is entitled to great weight in determining its investment quality.[1]

IV. PETITIONERS' ATTEMPTED EVASION OF THE LONG AND UNBROKEN LINE OF DECISIONS ESTABLISHING THAT THE "FAIR AND EQUITABLE" STANDARD INTERDICTS PAYMENT OF PREMIUMS IN A DISSOLUTION COMPELLED BY THE ACT, CANNOT WITHSTAND EXAMINATION.

In their brief, counsel for the Commission apparently deem it strategic to relegate to an obscure position the long and hitherto unbroken line of decisions in which the Courts and the Commission, over a five year period, have uniformly held that the fair and equitable standard interdicts the payment of premiums upon senior securities re-

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by Engineers forced them up. Standard & Poor's Investment Service rated them C** at the end of 1944 (the last year in which it rated preferred stocks), which rating was defined as "Preferred stocks with erratic dividend records, and which can be expected to make payments only under favorable conditions" (R. 1844a).

[1] Indeed, authorities in this field point out that even in weighing the investment quality of a corporation's *bonds*, particular attention is accorded to the dividend history of that same corporation's *stocks*. See, for example, GRAHAM & DODD, SECURITY ANALYSIS (1940), pp. 123-4.

See also testimony of Barnes on this subject at R. 661a.

tired under the impact of Section 11.[1] That is, of course, their privilege; but we do not believe the same can be said of the manner in which their brief discussion of and reference to the decisions allegedly relevant, *obscures and gravely confuses the issue.*

We urge that the Court accord this discussion its careful examination. It is as follows (S. E. C. Brief, pp. 79-81):

> "Finally, common stockholders cite a number of cases in which the Commission approved plans calling for the payment of amounts equivalent only to the involuntary liquidation preferences of the securities involved, and contend that this precluded approval of the Engineers plan on the basis of what is termed the 'Commission's new views'. * * * It is true that, in many instances, the Commission has found that the equitable equivalent of a security to be surrendered was only its involuntary liquidation preference.[47] It is equally true, however, that many of these cases have stressed the absence of indication of any investment value in excess of that amount,[48] and other cases have permitted the retirement of senior securities for amounts in excess of the involuntary liquidation preference.[49]" (Original footnote numbers retained.)

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[1] See decisions in our Main Brief at pp. 51-67, and cases collated at p. 55, notes 3 and 4.

As is pointed out at p. 64, note 1 of our Main Brief, the Commission's first and only departure from this line of decisions prior to the instant case was made at the end of 1945 in the American Power & Light debenture decision (Holding Company Act Release No. 6176), but the issue was not raised in the courts for the special reasons discussed. A second decision, that in *United Light-American Light & Traction Company* (Holding Company Act Release No. 6603) was decided by a 3-2 decision, which was subsequently reconsidered and mooted under the circumstances stated in the note referred to above.

We first direct attention to the last phrase of the quoted statement, "and other cases *have permitted* the retirement of senior securities for amounts in excess of the involuntary liquidation preference", and point out that this statement and the decisions cited in the appurtenant footnote (with certain exceptions to be discussed) have no relationship whatever to the issue in this case. The decisions referred to in footnote 49, with the exceptions hereafter discussed, relate either to voluntary refundings of senior securities in connection with an 11(e) plan submitted by a company which was continuing in existence [1]; or to declarations by continuing operating or holding companies of their intention to refund outstanding senior securities in the normal course of their operations through the exercise of the Company's contractual redemption right, in order that they might replace the retired senior securities with new ones carrying lower rates of interest or dividends. This is what is meant by the obscure sentence appended at the end of note 49:

> "Most of these cases were not approved as part of a Section 11(e) plan due to their nature, for where management agrees that payment of the redemption price is fair and equitable the normal procedure simply requires a call of the security."

In short, after clearly implying in the textual discussion that in many situations analogous to that of the in-

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[1] E.g., *In re United Gas Corp.*, 58 F. Supp. 501 (D. C., Del., 1944), which the Commission, in its report to Congress (11th Annual Report, p. 67, note 2), stated was a case in which it held: "that if a senior security could be left outstanding in a recapitalization of a company under Section 11(e) consistently with the requirements of Section 11(b), the retirement of such security, although provided for in a Section 11(e) plan, will be considered as a voluntary exercise of the redemption privilege rendering the call premium payable as such."

stant case, payment of premiums has been found "fair and equitable" by the Commission, buried away at the lower extremity of a long footnote is Commission Counsel's admission that "most of these cases" had nothing whatever to do with a Section 11(e) liquidation, and involved no consideration of the "fair and equitable" standard of that section because they related merely to normal *refunding operations* of continuing enterprises.

However, further confusing consideration of the issue, there have been included, without distinction, in note 49 certain decisions of a somewhat different ilk. For example, there has been included the *American Power & Light* decision (Holding Company Act Release No. 6176) which, as we have previously pointed out,[1] marked the first and only consummated decision prior to that in the instant case, where the Commission applied its new "investment value ex the Act" doctrine in holding that senior security holders were entitled to premiums in liquidations under the Act. Also included are:

(1) the Commission's *Pennsylvania Edison Company* decision (discussed in our Main Brief[2]), in which the Commission recently ordered payment of premiums in a Section 11(e) reorganization where the Commission emphasized that the enterprise continued augmented by merger, and had been permitted to replace the retired senior securities with others carrying lower dividend rates.[3]

[1] See *supra*, p. 51, note 1, and our Main Brief, p. 64, note 1.

[2] Main Brief, p. 115, note 1.

[3] Cf. also *Standard Gas and Electric Company*, Holding Company Act Release No. 6435, also cited in note 49, where after it had been held by the Commission and the Courts that the debenture holders were not entitled under the "fair and equitable" standard of Section

(2) *El Paso Electric Company*, 8 S. E. C. 366, where an operating company in the Engineers system (El Paso of Texas) refunded its outstanding senior securities with others carrying lower charges, and its parent holding company (El Paso of Delaware) was permitted to invite tenders of its outstanding preferred stocks at prices "not to exceed" the redemption prices. Morever, the Court is not advised of the fact that, several years later when it was found that El Paso of Delaware must be liquidated, the Commission squarely held that it was "fair and equitable" to retire its preferred stocks at their liquidation preferences of $100 per share, rather than the redemption prices of $110 and $115 per share at which the preferred stocks had been selling in the market for some time past.[1]

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1 (e) to payment of premiums, the company was subsequently permitted to call and redeem its notes and debentures (which carried interest rates of 6%) with proceeds of notes carrying an interest rate of 2½%, when changed conditions required indefinite postponement and complete revision of the reorganization plan of the continuing holding company.

[1] *El Paso Electric Company*, Holding Company Act Release No. 5499 (1944). The Commission specifically noted that on a "going concern basis" the preferred stocks would have a value in excess of $100 per share, but deemed such considerations "unrealistic", stating (p. 89):

> "Solely on an earnings and dividend basis, the Series A preferred stock may well be worth more than $100 per share plus accrued dividends. However, *appraisal of the stock on that basis is unrealistic in view of the charter limitation provision and the non-functional character of the company.*" (Emphasis supplied.)

It may be argued by petitioners, as it was below, that the Commission deemed the liquidation provision of the charter controlling because Engineers had sufficient voting power to dissolve El Paso of Delaware "apart from the impact of Section 11." This argument merely side-steps the issue. Careful reading of the decision will establish that the dispute between the majority of the Commission and the one dissenting Commissioner centered exclusively on the

Although the cases cited in note 48 do contain discussion of the fact that the securities being retired had had a checkered career in terms of their past market and dividend history, it is pertinent to note that, as we have already shown,[1] those factors are the very ones which the Commission chose to ignore in the instant case and which petitioners berate the Courts below for not finding wholly irrelevant. Furthermore, such discussions were advanced by the Commission as subsidiary considerations in reply to the contentions of the senior security holders that the *present* value of their securities, and their *future* value if permitted to remain outstanding, entitled them to receive payment of premiums.[2] For the paramount answer of the Commission and the Courts, as we have shown, is that the "fair and equitable standard" precludes payment of compensation for the "disappointed expectations" arising from the premature termination of senior security holders' investments, when such termination results from the enforcement of the overriding public policy embodied in Section 11 of the Act; or, in the Commission's own words:

> "It seems to us a complete answer to this argument that the termination of the investments of debenture holders and stockholders alike has been brought about

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question of whether a genuine *liquidation* was taking place (as the term was employed in the charter). The dissenting Commissioner argued that this was not a "liquidation" within the charter meaning, because the underlying portfolio securities were merely transferred to the parent holding company (Engineers) and might thereafter be distributed to its own stockholders. He stressed that the preferred stocks unquestionably had a "fair value" on a going concern basis far in excess of their liquidation claim; but, as has been pointed out, the majority found that a liquidation was taking place within the charter meaning, and consideration of the theoretical "value" of the preferreds "apart from liquidation" was consequently "unrealistic".

[1] *Supra*, pp. 49-50.

[2] See discussion in our Main Brief, p. 66, note 10.

by the act of a sovereign power—in this case a congressional mandate." *The United Light & Power Company*. 10 S. E. C. 1215, 1228.[1]

And to the argument that the stockholders in that case would nevertheless continue to retain their interest in a continuing holding company system, contrary to the situation in the instant case, the Commission stated:

> "* * * neither Power nor a successor company is retaining or can retain the capital obtained from the sale of the debentures for the benefit of the system. The debenture holders are being repaid the principal of and accrued interest on their debentures, are restored to their original position and are not compelled to accept the risks of a new enterprise. Under these circumstances, as we have heretofore shown, the debenture holders are not entitled to anything more."[2]

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[1] It is to be noted that in a number of the Commission's Annual Reports to Congress it called attention to its repeated invocation of this principle. Thus, in its 10th Annual Report the Commission stated (p. 87):

> "As noted in the section on 'Integration and Simplification of Holding Company Systems', the Second and Seventh Circuits and the District Court of Delaware in these cases upheld orders of the Commission's determination that it would be unfair and inequitable to the other security holders of the companies to give the debenture holders a premium *or other compensation* for premature termination of their rights in the context of a reorganization or liquidation required by the Act." (Emphasis supplied.)

Cf. 9th Annual Report, p. 41; 11th Annual Report, p. 67.

These assurances were before Congress at the time hearings were conducted by a special committee of the House of Representatives to consider whether the Act required amendment: see, "Hearings before the Securities Sub-committee of the Committee on Interstate and Foreign Commerce, House of Representatives, on 'Operations pursuant to the Public Utility Holding Company Act of 1935'" (79th Cong., 2d Sess., 1946); referred to in our Main Brief at pp. 137-8.

[2] Brief of Commission in *New York Trust Co.* v. *S. E. C.*, quoted in our Main Brief, pp. 58-9.

In the light of these facts, Commission Counsel now advance the suggestion—somewhat diffidently, to be sure—that

> "In the case of a preferred stock, moreover, what is involved is an ownership interest in the enterprise—not a creditor claim * * *" (S. E. C. Brief, p. 83).

In so doing, they urge upon this Court a distinction which the Commission itself has repeatedly found to be of no significance whatever in respect of the principle here under discussion, *since the Commission has repeatedly applied it to preferred stocks as well as to debt securities.*[1] And, as we have pointed out, the only decision prior to the instant case in which the Commission departed from the frustration principle to award premiums under the "investment ex the Act doctrine" was one involving the retirement of "a creditor claim", viz., the debentures of American Power & Light Company.[2]

The two remaining contentions on this subject are equally devoid of merit. It is implied (S. E. C. Brief, p. 82) that this Court's *Otis* decision in effect overruled the principles embodied in the long line of frustration cases, a curious conclusion to draw in view of the fact that, as we have pointed out, the *Otis* decision cites the

[1] Thus, in the very first case in which the Commission squarely spelled out the frustration doctrine, the Commission pointed to its precedent in permitting the preferred stocks of National Power & Light to be retired without payment of premiums (see *The United Light & Power Co.*, 10 S. E. C. 1215, 1226-1227 [1942]); and in *Cities Service, Power & Light Corp., et al.*, Holding Company Act Release No. 4944 (1944), the Commission squarely held the doctrine applicable to the retirement of debentures and *three issues of preferred stocks*, without the slightest attempt at any distinction.

[2] *American Power & Light Company*, Holding Company Act Release No. 6176.

frustration cases with approval.[1] Finally, it is in effect suggested the Commission should be permitted to determine the application and meaning of the "fair and equitable" principle as it deems appropriate "in view of the accumulated administrative experience."[2] We submit that when Congress embodied in Section 11(e) the "fair

[1] See discussion at pp. 65-67 of our Main Brief. With reference to this same contention which Commission Counsel now advance, Commissioner Healy stated:

> "It is interesting to note that in a Commission memorandum filed in opposition to a motion made by the New York Trust Company to the Circuit Court of Appeals for the Second Circuit to vacate its decree in the *New York Trust Company* case on the ground that it was inconsistent with the *Otis* case, *supra*, the Commission stated:
>
> > 'The majority opinion of the Supreme Court in the *Otis* case cites the decision of this court with approval * * *.'"

[2] "However, we believe it is entirely clear from the Commission opinions that each case involved a progressive analysis of the problems presented, and that the peculiar problems of each case were considered in view of the accumulated administrative experience" (S. E. C. Brief, p. 82).

It may be observed that at the time the Commission issued its *American Power & Light* decision applying the "investment ex the Act" doctrine for the first time, Commissioner Healy, who strongly dissented, was the only Commissioner who had been a member of the Commission from the time the Commission commenced administration of the Holding Company Act. Commissioner Healy had, in fact, been one of the persons most intimately connected with the enactment of the Holding Company Act, having been Chief Counsel to the Federal Trade Commission throughout the seven-year utility investigation which resulted in enactment of the statute (see recitals in Sec. 1(b) of the Act) and having been one of the principal witnesses in support of the proposed Act when it was under consideration before Committees of both Houses of Congress (Commissioner Healy actually carried the major burden of supporting the bill before the House Committee: see Hearings on H. R. 5423, Committee on Interstate & Foreign Commerce, House of Representatives, 70th Cong., 1st Sess.).

With respect to the legislative intent, Commissioner Healy has stated:

> "When I signed the Report of the National Power Policy Committee to President Roosevelt [which the President forwarded to Congress along with his message asking enactment of the Holding Company Act], I understood the much quoted

and equitable" standard having a well-settled meaning in the law, it did not mean to give the Commission the power to alter that principle, any more than to alter applicable contract rights, from case to case. Not only is such an intention clearly negatived by the legislative history,[1] but imputing such an intention to Congress would, as we have previously urged, raise constitutional questions of the most pressing character.[2]

V. PETITIONERS DISTORT THE LANGUAGE AND REASONING OF THIS COURT IN THE *OTIS* CASE.

Apart from this Court's decision in the *Otis* case, petitioners point to no authority for the Commission's claimed power to remold the rights of senior security holders whose interests are being retired for cash in a genuine liquidation under the compulsion of the statute. In our main brief (pp. 34 *et seq.*) we have shown that the historical meaning of the term "fair and equitable" implies enforcement of contractual terms and the payment of no more than the liquidating preference to senior

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references to preservation of investment values to refer to the values of operating company securities in holding company portfolios. I did not then and do not now believe it was intended as a basis for denying the senior security holders their full priority rights or for *compelling common stockholders to pay premiums upon the redemption or retirement of senior securities forced by federal statute. The common stockholder is not responsible for premature termination of the senior security holders' investment or for the premature termination of the common's own investment.* The responsibility for both rests upon the federal statute." (*United Light-American Light & Traction Co.*, Holding Company Act Release No. 6603, pp. 43-44; emphasis supplied.)

[1] Main Brief, pp. 36-7.

[2] *Id.*, at pp. 67-71.

security holders whose "matured" claims are being retired for cash under compulsion of law, and that this meaning was imported into Section 11(e) by Congress. We have shown further that the proponents of the Act contemplated that upon the final liquidation of a holding company system its assets would be distributed, as upon the liquidation of a combination in violation of the Hepburn and Sherman Acts. And this Court so stated in *North American Company* v. *S. E. C.*, 327 U. S. 686, 707. Such liquidations require execution of the contractual liquidation claims of the security holders. *Cf. Continental Insurance Co.* v. *U. S.*, 259 U. S. 156.

(1) In reliance on the *Otis* case, however, petitioners contend (S. E. C. Brief, pp. 22-28) that the "fair and equitable" standard of Section 11(e) entitles senior security holders of all dissolved holding companies to receive the value of their total "bundle of rights" "on a going concern basis" regardless of whether the particular dissolution is merely a reclassification of security holders' interests in a continuing enterprise or is a genuine liquidation; and regardless of whether the security holders are paid off in cash or receive new securities in the continuing enterprise. And, according to petitioners, compensation for the loss of the senior security holders' rights "on a going concern basis" must take account of both the liquidation preference and the preferred claim to earnings (S. E. C. Brief, pp. 28-34).

We have contended (Main Brief, pp. 45-50) that in the *Otis* case this Court decided only that when, in fact, the dissolution of a top holding company results in no more than a reclassification of the interests of security holders in a continuing holding company system, such

a dissolution is in effect a "reorganization" and not a liquidation within the meaning of the corporate charter. Therefore, the claims of the United Light preferred stock holders in that case, having no contractual right to maturation, and being in fact exchanged for other claims in the continuing enterprise, were properly "evaluated" on a "going concern basis", as in a reorganization. To say this, of course, is not to say, as Commission Counsel now contend, that when in fact the enterprise is completely terminated and its assets finally distributed, the rights of the security holders who receive cash payments in the full amount of their liquidation preferences must be augmented by compensation for the surrendered claim to future dividends, on the purely fictional hypothesis that "the enterprise continues".

The Commission's position rests primarily upon a single paragraph of the Court's opinion in the *Otis* case. In that case, the Commission had argued, as a justification for not treating the charter liquidation provisions as binding, that "the enterprise was continuing in an altered form and without substantial change in the total of the inherent rights of the security holders" (S. E. C. Brief, p. 76). The Commission now asserts that this Court "expressly disavowed" that "restrictive analysis" as the ground for its decision in the *Otis* case, and rested its conclusion on the broader ground that senior security holders in dissolutions under Section 11(e) must always be compensated for the loss of their total "bundle of rights" "on a going concern basis"—even though the dissolution is a final termination of the entire enterprise and the seniors are being paid off in cash.

The only evidence to which the Commission points (S. E. C. Brief, pp. 25, 77)—or can point—in support of this view is a quotation from the Court's opinion (at p. 638) reading:

"The reason does not lie in the fact that the business of Power continues in another form. That is true of bankruptcy and equity reorganizations. It lies in the fact that Congress did not intend that its exercise of power to simplify should mature rights, created without regard to the possibility of simplification of system structure, which otherwise would only arise by voluntary action of stockholders, or, involuntarily through action of creditors. We must assume that Congress intended to exercise this power with the least possible harm to citizens" (p. 638).

A conclusive answer to petitioner's contention is furnished on the face of the Court's opinion. The Court explicitly stated:

"There is an argument that if the charter provision applies to this situation, it cannot be disregarded, that in such a liquidation 'fair and equitable' would require the distribution of assets only to the preferred. We do not reach that question. The point at issue is whether this charter provision applies" (pp. 635-6).

In the light of this Court's explicit definition of the narrow "point at issue" in the case, the quotation upon which Commission Counsel rely can hardly have the meaning which they seek to impute. And examination of that quotation in its context[1] establishes that it has

[1] The majority's statement was plainly directed to the statement in the dissent (p. 648). " * * * the Commission in this case is liquidating and dissolving, not reorganizing United, and * * * it is without authority in such a case more than in a reorganization to alter or disregard a contract fixing the priorities of stockholders * * *."

reference solely to an interchange between the majority and the minority as to the reason why charter liquidation provisions are deemed controlling in bankruptcy reorganizations (which involve a continuing enterprise) but were not deemed controlling by the majority with reference to the United Light dissolution, although that also involved a continuing enterprise. We think it is plain beyond dispute that what the majority opinion was stating was that the reason for treating the continuing enterprise there involved differently from a continuing reorganized or bankrupt enterprise, must necessarily have lain in something other than the characteristic which both types of "reorganization" had in common, i.e., continuance of the enterprise. The reason the Court gave for such different treatment was that Congress did not intend the Act to "mature" the security holders' liquidation rights when the only circumstances upon which the security holders had agreed to have their rights matured—i.e., insolvency or final liquidation of their enterprise—had not occurred."

Indeed, an examination of the reorganization process makes this conclusion indisputable. In a reorganization, senior security holders must be compensated in full for the "bundle of rights" they surrender. If this compensation is awarded in the form of new securities in the reorganized company, the senior security holder does not receive the cash which would represent his fully matured claim. Since reorganization "matures" his claim, and he thus fails to receive what he is entitled to get on this maturity—i.e., the cash payment—he is held entitled to receive additional value, as compensation for the loss of the prior claim to earnings for which he is required to substitute a new claim to earnings. It is significant that

if, in fact, he received the cash which would represent his fully matured claim, he is not entitled, in addition, to receive compensation for the loss of his prior claim to earnings. *Cf. Knight* v. *Wertheim & Co.*, 158 F. 2d 838, 843 (C. C. A. 2), cert. den. sub nom.; *McGuire* v. *Equitable Office Bldg. Corp.*, 331 U. S. 818; *Bailey* v. *Minsch*, 168 F. 2d 635, 637 (C. C. A. 1), cert. den. 69 S. Ct. 83; cf. *The United Light & Power Co.*, 10 S. E. C. 1215, 1225.

The reason for this is as apparent as it is sound. The enterprise promised to give the senior security holder either a prior cash payment upon the maturing of his claim, or a prior claim to earnings for so long as such "maturing" did not occur. He was not promised, and in reorganizations he never receives, both priorities simultaneously. In a word, he cannot enjoy his cash maturation priority at a time when there is no maturation. By the same token, once his cash maturation priority has been fully satisfied, he can no longer enjoy, or receive compensation for the loss of, his prior claim to future earnings.

Because the problem presented by the dissolution of the top holding company in the *Otis* situation, like the problem presented by a bankruptcy or equity reorganization, involved only the redistribution of the security holders' interests in a continuing holding company enterprise, both the Commission and this Court analogized the one to the other. Since the dissolution there occurring was not a genuine liquidation and the senior security holders were not being paid out in cash, the only valid occasion for "maturing" their liquidation preference—i.e., paying them $100 per share plus accrued dividends, in cash—had not arisen. Accordingly, the senior security holders were held entitled to be compensated by receiving

the equitable equivalents of the total claims—including prior claims on liquidation and to earnings—which they were surrendering under the compulsion of the statute.

Here, however, we are faced with a wholly different situation. Not only was there a genuine liquidation, but it was a liquidation in which the preferences of the senior security holders were fully met in cash.[1] Under those circumstances, the preferred stockholders, having received their full liquidation preference, are not entitled to receive, in addition, amounts designed to compensate them for the

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[1] This distinction was clearly pointed up by Judge Leahy in a decision subsequent to that in the instant case, where preferred stockholders of a continuing holding company system were accorded new securities in a face amount equal to the redemption prices of those which they surrendered. In his opinion in that case (*In re Cities Service Co.*, 71 F. Supp. 1003) Judge Leahy stated (at p. 1005):

> "Even if the 3% debentures were the equivalent of money, I think the payment in a principal amount to include the liquidating premium would be fair and equitable and that this case is readily distinguishable from the Engineers Public Service Co. case. In Engineers payment was made to the preferred stockholders in a 'true liquidation'; the charter provided for no premium in a case of an involuntary liquidation; the market history indicated that the preferred would be treated fairly without payment of the premium; and hardship had been worked on both classes of stockholders as a result of divestment orders. In the matter at bar, there was no distinction made in the charter between voluntary and involuntary liquidation. The record indicates common stockholders have achieved great advantages to the detriment of the preferred and the preferred has generally been abused from non-payment of dividends. Here, there has been no hardship worked on any stockholders as a result of divestment orders, and the preferred stockholders are receiving a lower interest rate as a result of the exchange. * * * Since this is not a true liquidation but is a pseudo-liquidation similar to that involved *In re United Light & Power Co.*, D. C., 51 F. Supp. 217, affirmed *In re Securities and Exchange Commission*, 3 Cir., 142 F. 2d 413, aff'd *sub. nom. Otis & Co.* v. *S. E. C.*, 323 U. S. 624, 65 S. Ct. 483, 89 L. Ed. 511, the problem raised in Engineers (i.e., whether the charter provisions do not control in cases of a true liquidation) and which problem was left open in Engineers, does not arise here."

theoretical loss of future dividends at a rate claimed to have been attractive.

(2) Commission Counsel also contend (Brief, pp. 77-78) that the power to "remold" contractual rights, which it is asserted this Court found Congress had bestowed upon the Commission, can be no narrower in the final dissolution of a holding company system than in any of the initial or intermediate dissolutions which produce a continuance of the holding company system in a less complex form. But the *Otis* case, as we have shown, rested upon a finding that the dissolution there occurring was not a liquidation within the corporate charter, rather than upon a finding that the Commission had the power to remold applicable charter liquidation rights. And, in any event, it is plain that the rationale which vindicates the power equitably to adjust unmatured rights in the initial or intermediate simplification of a continuing holding company system, does not apply when the final act of termination of the system occurs and cash is being distributed to the senior security holders.

Indeed, this has been expressly recognized by the Commission itself in a recent decision in which it discussed the compensation to be accorded to preferred stockholders of a continuing enterprise, augmented by merger. Stating that under "the federal standard" of fairness and equity as embodied in Section 11(e), "primary weight in valuation must be accorded the claim to earnings and the economic position of the security in the enterprise", the Commission then added:

> "This is not to say that in certain situations of bona fide liquidation the charter liquidation prefer-

ences may not be treated as carrying *determinative weight* in applying the federal standard of fairness"[1] (Emphasis supplied.)

Here we have evidence of an awakening awareness by the Commission of the distinction which must be drawn between determining the rights of security holders in a reorganization of a continuing enterprise such as was involved in the *Otis* decision, and determining their rights in the case of a final liquidation of the entire system such as we have in the instant case. Further, this statement evidences the Commission's actual recognition, as distinguished from the arguments of its counsel here, that the *Otis* decision does *not* require or justify disregard of contractual liquidation rights in an authentic liquidation, and evaluation of rights on the fictional hypothesis of a "going concern".

The basis for the distinction now recognized by the Commission, but not by its counsel, between the determination of senior security holders' rights in a continuing holding company system as compared with their rights where final liquidation occurs, lies in considerations of an obvious and cogent nature. When the final step terminating the holding company system occurs and the senior security holders are paid out in cash, they are no longer forced to bear the risks of the continuing enterprise. To be sure, they have lost a claim to future preferential dividends; but they have acquired liquid cash and they are not being confined to an investment embodying the risks of the very system in which they had invested, at the same

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[1] *Pennsylvania Edison Company*, Holding Company Act Release No. 8550, p. 37, note 40 (October 16, 1948).

time that they are required to forego the position which they previously had.

(3) Commission Counsel further suggest (pp. 77-78) that if the Commission is powerless to remold the contractual rights of senior security holders on the retirement of those securities for cash in the course of the final liquidation of the system, "the management [of a holding company] by its choice of procedure would have the power to give preferred treatment to a particular class of security holders". Therefore, they argue, the Commission must have the power to prevent the management from favoring one class of security holders over another by choosing one form of dissolution rather than another. There can be no question that the Commission and the Courts have both the power and the duty to cut through formal devices by which a management seeks improperly to favor one group over another.

However, it is one thing to prevent a management from utilizing formally correct channels to effectuate an improper purpose, and it is another to deny to the security holders the effectuation of their charter rights when no such improper purpose is found or can be found. Whatever may be the powers which the *Otis* decision confers upon the Commission to supervise the management's choice among the varied alternatives facing it at the initial or intermediate steps in the lengthy process by which holding company systems are ultimately dissolved, a different problem is presented when the final act in distributing the assets of the system occurs.

At that time there is literally no preference that the management can give. The preferences of the security holders are defined by their charter rights upon liquidation. If the senior security holders are to be paid out in cash, they are entitled to no more than their contract provides. If they are to be paid out in securities, it is the duty of the Commission and the Section 11(e) court to see that the value of the securities which they receive is no greater or less than their contract entitles them to receive on liquidation. To be sure, even then, if it is found that the management, for an improper purpose, selects one form of dissolution—such as a merger—rather than a liquidation, as the device to terminate the system, the Commission and the Section 11(e) court have ample power to frustrate the execution of such purposes. But there is no such finding here. On the contrary, as we have shown, in spite of the determined efforts of the preferred stockholders who are petitioners here to establish in the course of the hearings before the Commission an improper purpose on the part of the management, no such purpose either is suggested by the record or was found by the Commission (*supra*, pp. 7-19).

(4) Finally it is urged that unless the Commission has the power to remold liquidation preferences, either the preferred stockholders may receive less than the "going-concern value" of their investment or the common stockholders may be wiped out despite a finding that "the common stock has a reasonable prospect of sharing in future earnings" (S. E. C. Brief, p. 78). But in this case the Commission gave no consideration to the common stockholders' loss of their "reasonable prospect of sharing in future earning." Moreover, this contention is simply an-

other way of stating that Congress did not intend the preferences which the security holders had agreed would govern the distribution of assets upon a final liquidation, to apply when such liquidation is compelled by the Act. As we have pointed out, nothing in either the language or history of the Act or in any judicial decisions supports this contention. On the contrary, all the evidence points inexorably to the conclusion which the Commission itself has apparently lately reached (supra, p. 67) that when a bona fide and final liquidation occurs and the security holders are paid out in cash, Congress intended the assets to be distributed in accordance with the agreement of the parties.

In point of fact, the formula used by the Commission in the instant case to compute the "going concern values" for which it claims Engineers preferred should be compensated does not suggest that, if given the power to alter contractual rights, the Commission's exercise of that power will allay the fears that preferred stockholders might receive less than the going concern values which they are forced to surrender, or that the common might be wiped out. Not only would that formula produce precisely the results the Commission purports to seek to avoid, but in this case it has deprived the common of values to which they were entitled under the very reorganization standards the Commission contends should be applicable.[1]

[1] Commission Counsel state that the formula employed by the Commission in this case was based on "the Euclidian axiom that the sum of the parts equals the whole" (S. E. C. Brief, p. 43), and that the Commission was therefore justified in evaluating the rights of the preferred stockholders alone "ex the Act", leaving the common stock-

VI. THE POWERS OF THE DISTRICT COURT TO DEAL WITH A SECTION 11(e) PLAN ARE CLEARLY BROADER THAN THE REVIEW POWERS OF THE COURT OF APPEALS UNDER SECTION 24(a); THE DISTRICT COURT HERE DID NOT EXCEED ITS POWERS.

Our main brief, written before we had received the petitioners' main briefs, attributed to the Commission the contention which it had made in the Courts below that its conclusion upon the fairness and equity of a Section 11(e) plan must be accepted by the District Court unless lacking in "any rational and statutory foundation" or unless the Commission "has plainly abused its discretion" (R. 34). The petitioner Streeter still maintains that stand (Streeter Brief, p. 76). The Commission, however, has substantially abandoned that position. Its retreat, commenced in its petition for certiorari [1] is completed in

holders to receive merely whatever might remain. We do not understand that this "Euclidian axiom", whatever its other virtues, was intended to provide an authoritative formula for measuring the relative rights of security holders in either a liquidation or a reorganization under the "fair and equitable" standard. Cf. *Jerome Frank, Mr. Justice Holmes and Non-Euclidian Legal Thinking* (1932), 17 Cornell Law Quart., 568, 573-4 (see quotation at R. 101-2).

In the *Otis* case, the demand of the preferred stockholders for 100% of the assets was entirely consonant with this "Euclidian axiom", since "the sum of the parts equalled the whole"; but the Commission and the Courts held that such a distribution was *not* consonant with the "fair and equitable" standard which governs reorganizations and liquidations under Section 11(e).

[1] "The Commission agrees with much of what the court below states concerning the intention of the Congress to have the Section 11(e) court function as an independent check upon the Commission's determination that a plan is fair and equitable and also that the respective roles of Commission and enforcement court should be in general similar to the relationship under Section 77 of the Bankruptcy Act between the Interstate Commerce Commission and the reorganization court." (Commission Petition No. 226, p. 22.)

its main brief when it agrees with the Court below that the second *Chenery* case (*S. E. C. v. Chenery Corp.*, 332 U. S. 194) is inapplicable to the present case.[1] Other concessions made in the Commission's brief will be referred to presently.

(1) However differently it may be phrased and from whatever angle it may be presented, the fundamental argument advanced by the Commission and the other petitioners on this phase of the case may be condensed as follows: a Commission order approving a Section 11(e) plan may be reviewed either by a District Court under Section 11(e) or by a Court of Appeals under Section 24(a), depending upon the whim of the company; review of Commission orders by the Court of Appeals under Section 24(a) is limited by the substantial evidence rule; there is no reason why the powers of a District Court to deal with a Section 11(e) plan presented to it for enforcement should be broader than the review powers of a Court of Appeals considering such a plan under Section 24(a), but, on the contrary, policy considerations would dictate that the same review standards be applied; therefore the limitations governing the Court of Appeals under Section 24(a) should be read into Section 11(e) and made applicable to the District Courts when they act under the latter section.

The Commission concedes that "A traditional function and responsibility" of the District Courts, as reorganization courts, "to exercise 'an informed, independent judgment' as to all matters arising in the reorganization * * *

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[1] "While we believe the court below gave the wrong reason for rejecting the applicability of the *Chenery* case, acceptance of our main argument leads to the same conclusion." (Commission brief, p. 112.)

survives in part, and gives the court a broader function than the mere determination of questions of law" (S. E. C. Brief, p. 103). The examples given to illustrate the admittedly "broader function" serve to limit the concession somewhat, but it seems to us beyond question that the concession, however it is sought to be limited, destroys the argument that the powers of the District Court in passing upon a Section 11(e) plan presented to it for enforcement are no broader than the review powers of the Court of Appeals under Section 24(a) of the Act. Moreover, the Commission concedes (Id. at p. 105) that it has itself "emphasized the 'independent duty' of the Section 11(e) court", as the Court below noted (R. 23-24). Although the Commission again seeks so to limit its concession as to drain of meaning the phrase "independent duty", the concession nevertheless further underscores the divergence between the powers of the District Court under Section 11(e) and the powers of the Court of Appeals under Section 24(a).

Apart from concessions, however, there is a fundamental fallacy in the argument of the Commission and the other petitioners above set forth which destroys its validity. Section 11(e) and Section 24(a) are *not* alternative avenues for judicial review of a Commission order approving a Section 11(e) plan. The Act did not contemplate alternative avenues of review and the Commission, in practice, has not permitted such alternatives.

Subsections (d) and (e) of Section 11 constitute, as the Commission itself has phrased it, "a self-contained reorganization statute".[1] The general review procedure

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[1] Commission's brief (p. 16) in *Lounsbury v. S. E. C.*, 151 F. 2d 217, quoted at page 139 of our Main Brief.

provided by Section 24(a) with respect to Commission orders is not necessarily applicable to orders made under Section 11(e). Proceedings under subsection (d) can be brought only in the District Court, and the same is true, of course, as to proceedings under subsection (f), which subsection is generally linked with (d) and (e) as part of the "self-contained reorganization statute". Indeed, since Congress admittedly had in mind the functions exercised by the District Courts under the Sherman and Hepburn Acts and under Section 77 of the Bankruptcy Act, it is evident that the congressional intent was that reorganization plans approved by the Commission under Section 11(e) should go from the Commission to the District Court rather than to the Court of Appeals.

Not only do the structure and legislative history of the Act suggest that the proper and exclusive "avenue" for judicial consideration of 11(e) plans is the District Court rather than the Court of Appeals,[1] but it seems to us that to permit alternative avenues of review would not be in accordance with the scheme of the Act.

The District Court has the facilities for giving notice and a hearing to all parties affected by the plan, whether or not they appeared or participated in the hearing before

[1] The exceptional case may arise where a reorganization proposed by the company under Section 11(e) contemplates steps which are either optional with security holders or dependent upon approval by security holders in strict accord with the provisions of the charter or applicable state statutes. Such a plan would not require District Court approval and, if reviewed at all, would be reviewed by the Court of Appeals. *Phillips* v. *S. E. C.*, 153 F. 2d 27 (C. C. A. 2), cert. den. 328 U. S. 860, was such a case. Cf. the sequel to this case (*United Corporation*, Holding Company Act Release No. 8396), in which the company's proposal for a *non-voluntary* exchange with its preferred stockholders was expressly conditioned upon District Court approval and enforcement, and the Commission's order of approval was also so conditioned.

the Commission; such practice is not customary in the Court of Appeals. The District Court is equipped to take additional evidence in connection with the plan or objections thereto; the Court of Appeals could not conveniently do so. The District Courts have traditionally been charged with broad responsibilities in equity and bankruptcy receiverships and reorganizations, and in reorganizations made necessary by the Sherman and Hepburn Acts; the appellate courts have never exercised such functions and are not organized to consider or decide the multitudinous administrative problems inherent in such matters. Since it seems desirable, and Congress specified, that notice and a judicial hearing be granted to all interested parties, that additional evidence be taken by the court where necessary, and that the reorganization be carried out under judicial supervision, it follows that the proper court to which Section 11(e) plans should be referred is the District Court and not the Court of Appeals.

In the early days of its administration of the Act and before the procedure thereunder had crystallized, there were some instances in which a Section 11(e) plan was permitted to be reviewed by a Court of Appeals under Section 24(a), but the Commission some years ago adopted the uniform practice of requiring that Section 11(e) plans affecting security holders' rights be conditioned upon District Court approval.[1] Such condition, as the Commission

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1 See the Commission's 10th Annual Report to Congress, and the testimony of Chairman Purcell, quoted at page 137 of our Main Brief; see also *Lownsbury* v. *S. E. C.*, 151 F. 2d 217, 218: "The conditional nature of the Commission's order is apparently a method of so framing its mandate as to avoid the seeming inconsistency involved in sections 11(e) and 24(a) of the statute. If effective, an orderly review following Commission action is provided for through District Court, Circuit Court of Appeals, and possibly Supreme Court, in proceedings in which all parties in interest may be participants."

concedes (S. E. C. Brief, p. 87), precludes direct review of the Commission's order under Section 24(a). *Okin* v. *S. E. C.*, 145 F. 2d 206 (C. C. A. 2); *Lownsbury* v. *S. E. C.*, 151 F. 2d 217 (C. C. A. 3), cert. den. 326 U. S. 782.

This practice, of channeling Section 11(e) plans to the District Court, is clearly in accordance with the statutory intent. It disposes of Commission Counsel's fear that management, by dictating whether or not an 11(e) plan shall be enforced in the District Court, could determine the scope of judicial review to which the plan would be subjected (S. E. C. Brief, p. 89).

Our conclusions find support in the concurring opinion of Biggs, C. J., in *Lownsbury* v. *S. E. C.*, 151 F. 2d 217, 221.[1] They are also in accord with the views expressed

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[1] After considering the provisions and interrelation of the subdivisions of Section 11, and the close analogy afforded by Section 77 of the Bankruptcy Act (p. 220), Judge Biggs concludes (p. 221):

> "I can perceive no more reason for holding that a security holder may avail himself of the review provisions of Section 24(a) when the company has filed a Commission approved plan under subsection (e) of Section 11 than for holding that the security holder is entitled to such a review when a plan approved by the Commission is filed under subsections (d) or (f). It is clear that Congress did not intend that a security holder should have the right to a Section 24(a) review of an order of the Commission approving a plan submitted to a district court pursuant to the provisions of subsections (d) or (f).
>
> "The method, technique or device adopted by the Commission in the instant case in conditioning its order as indicated seems proper and well within the procedural field allotted to the Commission by Congress. Certainly the device adopted can do no harm to the rights of a security holder. The interpretation of subsection (e) by the Commission is entitled to great weight since it is the agency charged by Congress with the administration of the Public Utility Holding Company Act. The fact that subsection (b) expressly provides for a Section 24(a) review while subsections (d), (e) and (f) do not, is also very persuasive. Cf. our decision in Marquis & Co. v. Securities and Exchange Com'n, 134 F. 2d 822, and the circumstances of the cited case."

by this Court in *North American Co. v. S. E. C.*, 327 U. S. 686, 709-710; in sustaining the constitutionality of Section 11(b)(1) as against attack under the due process clause of the Fifth Amendment, this Court relied upon the "statutory and judicial safeguards" incorporated by Congress into the Act against destruction of values through divestment or reorganization, foremost among such safeguards being the requirement that a plan of divestment or reorganization "must meet the standards of fairness and equitableness" and "must be carefully scrutinized by both the Commission *and the enforcing court*, thus enabling the assertion and protection of all shareholders' rights." (Emphasis supplied.)

(2) Apart from its contention that the presence in the Act of both Section 24(a) and Section 11(e) requires that the scope of District Court action under Section 11(e) be restricted so that it shall conform with the scope of Court of Appeals action under Section 24(a), the Commission's brief argues as follows: The power of the District Court under Section 11(e) is "similar" to the power of the District Court under Section 77 of the Bankruptcy Act (S. E. C. Brief, p. 90); the Court below "misinterpreted the scope of review of the Section 77 court, and misconceived what is meant by the exercise of an 'independent judicial judgment' to re-examine administrative findings" (Id., p. 94); the scope permitted to the District Court under § 77, and therefore under Section 11(e) is no broader than the powers given to the Court of Appeals under Section 24(a).

We believe, as we argued in our main brief (pp. 129-133), that because of restrictive language contained in Section 77 of the Bankruptcy Act, which has no counterpart in Section 11(e) of the Holding Company Act, the

power of the District Court under Section 11(e) is broader than its power under Section 77. However, even if that were not the case, we differ with Commission Counsel upon their interpretation of the powers of the District Court under Section 77 as this Court has construed such powers, and we submit that if the powers of an 11(e) court were no broader than the powers of a Section 77 court, the District Court here correctly refused to approve the plan notwithstanding the Commission's prior approval thereof.

Commission Counsel quarrel with a statement contained in our brief in the Court below that the effect of the last paragraph of subsection (e) of Section 77 is to confer upon the Interstate Commerce Commission "exclusive power over 'valuation of the debtor's property'" (S. E. C. Brief, pp. 94-95). It is true, as the Commission brief notes, that the word "exclusive" does not occur in the statute. But the interpretation of the statutory language is not ours; it is the interpretation declared by the majority of this Court in *Ecker* v. *Western Pacific R. Corp.*, 318 U. S. 448, where the Court stated (pp. 472-473):

> "The power of the [district] court does not extend to participation in all responsibilities of the Commission. Valuation is a function limited to the Commission, without the necessity of approval by the court * * * [The court then quotes the statutory provisions.] The function of valuation thus left to the Commission is the determination of the worth of the property valued, whether stated in dollars, in securities or otherwise. One of the primary objects of the bill was the elimination of obstructive litigation on the issue of valuation and the form finally chosen approached as near to that position as seemed to the draftsmen legally possible. Judicial re-examination was not considered desirable."[1]

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[1] Footnote references omitted.

Notwithstanding the evident intention of Congress to commit the function of valuation to the Interstate Commerce Commission and to withdraw that function from judicial re-examination, this Court held that the Commission's findings on valuation must nevertheless comply with legal standards and be supported by material evidence (318 U. S. at p. 473). "Another restriction on court action" which this Court cited, basing its conclusion on subsection (d) of Section 77, is "that the determination as to whether the plan is 'compatible with the public interest' rests, as valuation does, with the Commission" (Id., 473). As an example of the kind of question so committed to the Commission, this Court referred to "the amount and character of the capitalization of the reorganized corporation * * * the total amount of issuable securities and the quality of the securities to be issued" (Id., pp. 473-474). And this Court continued: "So long as legal standards are followed, the judgment of the Commission on such capitalization is final" (p. 474).

Thus it appears that even as to the two issues which rest with the Commission, as this Court held, without participation by the District Court, without necessity for District Court approval, and as to which judicial re-examination was not considered requisite by Congress—namely, valuation of the debtor's property and determination whether the plan is compatible with the public interest—this Court nevertheless assigned to the District Court the duty to determine whether the Commission's action was reached in accordance with legal standards and was supported by material evidence. Certainly, as to other issues raised by a reorganization plan, notably the issue whether the plan is "fair and equitable", and issues as to allocation

of securities among creditors and stockholders[1]—as to which issues the District Court is said to exercise an independent judgment—the function of the District Court must be something broader than the duty to determine whether the Commission's decision complies with legal standards and is supported by substantial evidence. Yet the Commission's argument on this point, if accepted, would lead to the conclusion that the District Court's functions upon all issues are limited in the same way—a conclusion directly opposite to that reached by this Court in the *Western Pacific* case.

We indicated in our main brief (p. 131) how this Court contrasted the limited review function of the District Court with respect to issues of valuation and public interest, on the one hand, with its functions of "independent examination" to be exercised on other issues. If "independent examination" means nothing more than reviewing the Commission's findings to determine whether they comply with statutory requirements and are supported by material evidence, the phrase is meaningless. Sensing this, the

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[1] The Commission's brief (p. 94) states:

"This Court decided in *Ecker* v. *Western Pacific R. Corp.*, 318 U. S. 448, 473, that as to matters of valuation *and allocation* the Section 77 court reviews the determinations of the Interstate Commerce Commission under the substantial evidence rule." (Emphasis supplied.)

The reference to "allocation" is erroneous. This Court held that the substantial evidence rule applies to the Commission's valuation of the debtor's property (relying on subdivision (e) of Section 77), and to the Commission's determination of the total amount and quality of securities to be issued (because that is a matter of "public interest" within the meaning of subdivision (d)). But it did not hold that the substantial evidence rule applies to the Commission's *allocation* of securities among the creditors and stockholders; on the contrary it is implicit in this Court's opinion that such questions are within the area where the District Court is permitted and required to make an "independent examination", and its own finding or affirmation.

Commission struggles to assign some significance to the phrase and to indicate some respects in which a District Court reviewing a Section 77 plan may be said to exercise some degree of independence. It begins with the assertion, "The reorganization court, of course, has an independent responsibility for all issues of law" (S. E. C. Brief, p. 102). That is hardly what this Court meant by the word "independent", as shown by its statement that, "While the public interest phase of capitalization is not to be independently passed upon by the court, the court does have statutory authority to review for obedience to legal standards." (318 U. S. at p. 475).

Recognizing immediately that Section 77 "gives the court a broader function than the mere determination of questions of law" (S. E. C. Brief, p. 103), the Commission proceeds to consider how much broader that function is; but it is willing to commit itself only in two respects: that "within limits, the district judge has responsibility to take evidence to decide whether the record on which the agency acted has become stale as a result of changing economic conditions", and that, "Inquiries as to matters of law or fact may be made on the court's own motion or at the behest of objecting parties who, by ordinary appellate standards, might be precluded from raising a question" (S. E. C. Brief, p. 103). Neither of the examples cited is a true instance of "independent examination". As to the power to take additional evidence, this Court held that the District Court has such power even with respect to a Commission finding of valuation, on which clearly the District Court has only the most limited review jurisdiction:

> "Thus, while judicial review does not involve an independent examination into valuation, it does require that the court shall be satisfied, upon the record before

the Commission, *with such additional evidence as may be pertinent to the objections to the Commission's finding of value*, that the statutory requirements have been followed" (318 U. S. at p. 477; emphasis supplied).

And as to the second example cited by the Commission, even a Court of Appeals reviewing a Commission order under the restrictive provisions of Section 24(a) of the Holding Company Act would, under the provisions of the section, have power to consider objections which, or to hear parties who, by ordinary appellate standards might be precluded.

The Commission has thus failed to suggest any respect in which a District Court, acting under Section 11(e) of the Holding Company Act or Section 77 of the Bankruptcy Act, may be said to exercise "independent examination", if in doing so the Court is to be limited, as the Commission contends, to determining whether the Commission's conclusions are supported by material evidence and are in accordance with legal standards.

Charging that the quotations from the legislative history of the Act, as set forth in the opinion of the Court below, "give an incomplete picture of the legislative background" (S. E. C. Brief, p. 100), Commission Counsel have attached as "Appendix B" to their brief more complete extracts from the Senate Report and the Senate debates (Id., pp. 127-185). But the Commission does not call attention to anything in the Report or in the debates, and we find nothing that alters or qualifies the effect of the portions quoted in the opinion of the Court below or in our main brief. While the debate concerned the question whether the District Court should be required to appoint the Commission as receiver or trustee, as the Court below noted (R. 22), and as we stated in our main

brief (p. 134), it is unmistakably clear from the tenor of the debate that the Senate placed special emphasis and confidence in the role of the courts rather than that of the Commission, and intended that the District Courts should retain their traditional reorganization function. In addition to the excerpts quoted in our main brief, we have reprinted in the margin other portions of the Report and debates which further exemplify that intention.[1]

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[1] The Senate Report, after summarizing the provisions of subsections (a), (b) and (c) of Section 11, states:

> "Precedents under the Sherman Antitrust Act and under the Hepburn Act demonstrate that the necessary corporate adjustments can be made without forced liquidation or the sacrifice of legitimate investment values." (Quoted in S. E. C. Brief, p. 142.)

The Report continues:

> "Subsections (d), (e) and (f) outline the procedure whereby the reorganization plans must be approved by the Commission and carried out under the supervision of the Federal courts" (Ibid.).

With reference particularly to subsection (e), the Report states:

> "Subsection (e) expressly authorizes a holding company subject to the approval of the Commission and the court to work out a plan of reorganization to make unnecessary the issuance of an involuntary order for its reorganization by the Commission, and the Commission and the court are authorized to approve any plan so worked out voluntarily by a holding company as the Commission and the court might order under their compulsory powers. *Thus the voluntary reorganizations of the holding companies might be facilitated by the recognized powers of a court of equity to make such equitable allocations of general liens and priorities as may be necessary to make it possible for the companies to comply with the policy of the statute* (Continental Insurance Co. v. U. S. Reading Co. et al., 259 U. S. 156)." (Id., p. 143; emphasis supplied.)

In the course of the debate, Senator Wheeler, replying to a suggestion by Senator Steiwer that the provision requiring the court to appoint the Commission receiver might be held objectionable as ousting the court of its jurisdiction, stated:

> "No; I do not think it would oust the jurisdiction of the court. * * * Furthermore, this is a mere matter of Congress providing the administrative machinery surrounding receiverships, and in no way usurping any judicial powers. *The judicial functions remain, as always, in the courts.*" (Id., pp. 151-152; emphasis supplied.)

(3) The Commission's brief concedes that if the Commission "did not apply the correct rule of law as to the rights of the stockholders, then of course the district court properly discharged its own statutory responsibility in refusing to approve the plan as approved by the Commission" (S. E. C. Brief, p. 85); and it argues repeatedly that the "basic issue" in this case is one of law (e.g., pp. 84, 108). We agree, as we argued in Part One of our main brief, that in a genuine liquidation such as took place here the "fair and equitable" standard required that the preferred stockholders be limited to $100 per share because of the corporate charter provisions specifically applicable to such liquidation, because of controlling precedents which compel the same result even if the charter liquidation provisions were not deemed applicable to this liquidation, and because of constitutional limitations which preclude a different result.

The Commission's next argument is "that the issue in this case, if not a pure issue of law, must be one of policy which would be for the Commission to decide under any theory of the scope of review" (S. E. C. Brief, p. 89), and it defines that issue of policy as follows: "whether inquiry should be confined to the operation of the particular plan before the Commission or should include a re-appraisal of all past transactions as if the Act had never been passed" (Id. at p. 109); the Commission concludes that upon such matters of policy its judgment should prevail unless "arbitrary or irrational" (Id., p. 110).

This statement of the disagreements between the Commission and the Courts is patently erroneous. The point at which the District Judge and the Court of Appeals on the one hand, and the Commission on the other, differed

was whether, on the assumption that the preferred stockholders were entitled to be compensated for the rights they surrendered "on a going-concern basis", the Commission correctly determined the "equitable equivalents" of the rights surrendered. This issue both the District Judge and the Court of Appeals decided against the Commission on the ground that, as a matter of law, the Commission used an improper and untenable formula for determining the compensation to which the preferred stockholders were entitled. While the Court of Appeals held that the Commission should have another opportunity to determine on a legally correct formula the "equitable equivalents" which the preferred stockholders should receive, the District Court determined that if a correct formula were used, on the record in this case the preferred stockholders could receive no more than $100 per share. Plainly, insofar as the issue between the Commission and the Courts was whether the Commission applied a legally valid formula to measure the equitable equivalents of the right surrendered by the stockholders under the impact of the statute, a question of law was presented, and the decision of the Courts is authoritative. The only question upon which a difference between the Commission and the Courts would require an exercise by the District Court of its admittedly "broader function than the mere determination of questions of law" (S. E. C. Brief, p. 103) is whether, on a legally correct formula, the facts would permit the result reached by the Commission. We submit that it is precisely at that point that the broader scope which Section 11(e) gives to a District Court comes into play, and that, as in this case, a District Court has the power to determine whether on a correct formula the facts would permit any result other than that which it reached.

(4) Finally the Commission argues, "To construe Section 11(e) as conferring on the district court a valuation function co-ordinate with that of the Commission would make the statute unworkable" (S. E. C. Brief, p. 112); either the Commission's conclusion on fairness and equity should bind the District Court, or the conclusion of the District Court should bind the Commission (Id., p. 114); and "in the interest of uniform administration of the statute" it is necessary that the conclusions of the District Court where he disagrees with the conclusions of the Commission should be subject in turn to full review on appeal (Id., p. 115).

Precisely the same problems of possible conflict between the Commission and District Courts as are here conjured up by the Commission could arise under Section 77 of the Bankruptcy Act; but this Court has not found it necessary either to restrict the independence of the District Courts so as to make them mere courts of review over the determinations of the Interstate Commerce Commission or to enlarge the customary review powers of the Court of Appeals or of this Court so as to make the review powers of the Appellate Courts co-extensive with the District Courts' functions. Instead, this Court has affirmed the difference between the functions of the District Court under Section 77 and the functions of Appellate Courts reviewing the action of the District Court.[1]

Both the District Court and the Commission are bound by the requirement that a plan must conform to the "fair and equitable" standard. If differences arise between the District Court and the Commission as to the meaning or

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[1] *Group of Investors* v. *Chicago, M., St. P. & P. R. Co.*, 318 U. S. 523, 564, quoted at p. 132 of our Main Brief.

application of that standard in the context of a particular case, the final decision rests, as always, with the Appellate Courts. It is thus evident that petitioners' arguments concerning the threat of "stalemate" stem primarily from their desire to have the Commission's determinations prevail in an area where Congress intended that security-holders would "have the protection of findings as to the fairness and equity of plans by both the Commission and a United States District Court" (10th Annual Report of the Commission, p. 65). Cf. *North American Co. v. S. E. C.*, 327 U. S. 686, 709.

Dated, January 5, 1949.

Respectfully submitted,

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